STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

FOCAL COMMUNICATIONS CORPORATION OF ILLINOIS	)	
Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Illinois Bell Telephone Company d/b/a Ameritech Illinois	)	**Docket 00-0027**

AMERITECH ILLINOIS' POST-HEARING BRIEF ON ISSUE 2

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The unqualified payment of reciprocal compensation for ISP-bound traffic does notpromote real competition in telecommunications. Rather, it enriches competitive local exchange carriers, Internet service providers, and Internet users at the expense of telephone customers or shareholders. This is done under the guise of what purports to be competition, but is really just an unintended arbitrage opportunity derivedfrom regulations that were designed to promote real competition. A loophole, in a word.

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ISP-bound traffic is almost entirely incoming, so it generates significant reciprocal compensation payments from [ILECs] to CLECs, an imbalance which enables CLECs to increase their profits or to offer attractive rates and services to Internet service providers-or to do both. Not surprisingly, ISPs view themselves as beneficiaries of this "competition" and argue fervently in favor of maintaining reciprocal compensation for ISP-bound traffic. However, the benefits gained, through this regulatory distortion, by CLECs, ISPs, and their customers *do* not *make society* as a *whole* better *off, because* they come *artificially at the expense of others.*

Where an increase in income results from regulatory anomaly, rather than from greater competitive efficiency in the marketplace, a regulator is well advise[d] to take his thumb off the scale. We do so today. Arguing that we should not correct the distortions created by reciprocal compensation payments because they benejit ISPs and their customers is much like saying that one should not encourage people to quite smoking, and so avoid adverse personal andpublic health consequences, merely because some members of society make a living growing tobacco. Decisions like this should be driven by concerns for overall societal welfare — and not by concerns for preserving the hothouse environment of an artificial market niche.

Order, Mass. Dept. of Telecomm. and Technology, in Complaint of MCI WorldCom, Inc. against New England Tel. Co. d/b/a Bell Atlantic — Massachusetts for breach of interconnection terms entered into under Sections 25 1 and 252 of the Telecommunications Act of 1996 (May 19, 1999) (Ex. 2 to Ameritech Illinois' Response to Focal's Petition for Arbitration), at * 1 5-* 17.

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INTRODUCTION AND SUMMARY OF ARGUMENT

Illinois Bell Telephone Company d/b/a Ameritech Illinois ("Ameritech Illinois"), respectfully submits its post-hearing brief on Issue 2, concerning inter-carrier compensation for ISP traffic.[1]

Focal asks the Commission to require Ameritech Illinois to compensate Focal for the costs Focal incurs when it delivers to its Internet service provider ("ISP") customers Internet traffic originated by those ISPs' subscribers who are also local exchange customers of Ameritech Illinois. Ameritech Illinois maintains that the Commission is without jurisdiction to entertain that request in this proceeding, for two reasons. First, the Commission's only charge in this arbitration under the Telecommunications Act of 1996 ("1996 Act") is to give effect to the substantive requirements of the Act, and the Act does not require Ameritech Illinois to compensate Focal for delivering Internet traffic to its ISP customers. Second, the Commission's authority under Illinois law does not extend to interstate telecommunications, and ISP traffic is interstate. The Commission's lack ofjurisdiction to decide Issue 2 is further discussed in Ameritech Illinois' Response to Focal's Petition for Arbitration ("Ameritech's Response"), at pages 4-6.

Ameritech's Response relied on the FCC's February 26, 1999, *ISP Order (Inter-Carrier Compensation for ISP-Bound Traffic*, FCC 99-38, Declaratory Ruling in CC Docket 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68), in which the FCC ruled that ISP traffic is not local and therefore is not subject to the reciprocal compensation provisions of the 1996 Act or the FCC's rules implementing those provisions. On March 24, 2000, however, the

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[1] Ameritech Illinois has submitted a separate post-hearing brief on Issues 1, 3, 4 and 7.

United States Court of Appeals for the D.C. Circuit, in *Bell Atlantic Tel. Cos. v. FCC, Nos. 99-1095 et al. ("Bell Atlantic")* (Attachment 1 hereto), vacated the *ISP Order* and remanded the matter to the FCC for an explanation of the basis for its rulings.[2] Ameritech Illinois therefore no longer relies on the *ISP Order*. *Bell Atlantic*, however, left open the question whether ISP traffic is or is not local, and Ameritech Illinois continues to maintain, and demonstrates below, that ISP traffic is not local and therefore is not subject to reciprocal compensation under the 1996 Act. Accordingly, the reasons that the Commission lacks jurisdiction to address Issue 2, as set forth in Ameritech Illinois' Response, remain valid.

In addition, the vacatur *of* the *ISP Order* eliminates the only basis for Commission jurisdiction to decide Issue 2 that has been advanced in this proceeding. As Staff witness Phipps said in his Verified Statement, in contending that the Commission had authority to decide Issue 2, the FCC indicated in the *ISP Order* that state commissions could impose inter-carrier compensation on ISP traffic in the interim preceding the FCC's forthcoming decision in its generic docket on the subject, and that state commissions could, in that interim period, treat ISP traffic as local for purposes of reciprocal compensation. (Staff Ex. 2 at 6-7.) With the *ISP Order* no longer the law, that authorization no longer exists.

The question whether this Commission has jurisdiction to decide Issue 2 was not actively litigated at hearing, and is not further discussed in this submission. Instead, the remainder of this brief sets forth Ameritech Illinois' position in the event that the Commission decides it does have

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[2] The FCC has already signaled that it will provide the explanation that the Court is looking for. FCC Common Carrier Bureau Chief Lawrence Strickling stated that he "still believes that calls to ISPs are interstate in nature and that some fine tuning and further explanation should satisfy the court that the agency's view is correct." See Attachment 2 hereto, first paragraph.

jurisdiction to decide Issue 2. In summary form, that position is as follows:

1. If the Commission entertains Issue 2, the prudent course would be to require the parties' interconnection agreement to provide for the parties to compensate each other (or not) for delivering ISP traffic in accordance with the FCC's forthcoming decision in Docket 99-68 (In *the Matter of Inter-Carrier Compensation for ISP-Bound Traffic*). Ameritech Illinois recommended this course in its Response to Focal's Petition, and it makes even more sense now than it did then, because the vacatur of the *ISP Order* has complicated Issue 2 by adding to it a new question -whether ISP traffic is local for purposes of the reciprocal compensation provisions of the 1996 Act — a question on which the record in this proceeding is undeveloped. (Section I *infra*.)

2. Focal can point to no existing statute or rule that requires, or even supports, the outcome it seeks on Issue 2. While the D.C. Circuit found inadequate the reasoning on which the FCC based its rulings in the *ISP Order*, this Commission should rule (and *Bell Atlantic* leaves it free to rule) that ISP traffic is not local, and therefore not subject to reciprocal compensation. In particular, the FCC rule that allows Focal to charge reciprocal compensation on local traffic at Ameritech Illinois' rates even if Focal's transport and termination costs are lower than Ameritech Illinois' should not come into play on Issue 2. Consequently, if there were any basis for the outcome Focal seeks on Issue 2, it would have to be found in economic and public policy principles. (Section II *infra*.)

3. Sound economic and public policy principles, however, dictate that Ameritech Illinois should not be required to pay Focal for delivering ISP traffic to its ISP customers, because Ameritech Illinois does not cause the costs that Focal incurs when it delivers that traffic. If one looks at ISP traffic without preconceptions, as the Commission is now free to do, one sees

that it is fundamentally different from local traffic, because the costs it imposes on the network are caused by the unique contractual arrangement between the ISP and its subscribers, an arrangement in which the ISP sells the subscribers a service that they can use only via the local network. When Ameritech Illinois' local exchange customers make local calls, they are availing themselves of the service they have contracted for with Ameritech Illinois, so Ameritech Illinois should pay, and does pay, carriers that help it provide that service by terminating the calls on their networks. But when those same persons originate ISP traffic, they are availing themselves of the service they have contracted for with their ISPs, so the ISPs should pay the carriers (Ameritech Illinois and Focal) that help it provide that service. And even if, as Focal argues, regulatory constraints excuse the ISPs from paying their own way, there is no basis in economic theory or public policy for requiring Ameritech to foot the ISPs' bill to Focal. (Section III *infra*.)

4. Even if the Commission were to conclude that Focal should, in principle, be permitted to recover from Ameritech Illinois its costs of delivering ISP traffic that originates on Ameritech's network, the Commission still should not grant Focal's request in this proceeding, because Focal failed to prove those costs. The FCC, in a situation that cannot be distinguished from this one, has directed state commissions that a carrier that arbitrates its entitlement to compensation for the costs it incurs when it delivers traffic to its customers must prove those costs, and the Commission should follow that direction here. (Section IV *infra*.)

5. If the Commission nonetheless decides to require Ameritech Illinois to pay Focal for delivering traffic to its ISP customers, Focal must not be allowed to charge a rate that allows it to over-recover its costs. Because of the enormous and ever-increasing volume of ISP traffic that originates on Ameritech Illinois' network and that is delivered to ISP customers of Focal and

other CLECs, a rate that is over-compensatory by even a fraction of a cent per minute would have an equally enormous and socially undesirable impact. It would, among other things, operate to suppress competition for customers who use dial-up Internet access, particularly residential customers, and to retard the development of advanced and efficient alternatives to dial-up Internet access. (Section V *infra.*)

6. In a display of untempered avarice, Focal asks the Commission to allow it to charge for delivering ISP traffic at the same rate that the parties pay each other for transporting and terminating local traffic. That result is unthinkable. As Staff has concluded, the rate the parties pay each other for transporting and terminating local traffic would vastly over-compensate Focal if it were extended to ISP traffic.

To try to ensure that Focal is not over-compensated, the Commission should, if it awards any compensation at all,

- require Focal to recover at least some of its costs for delivering ISP traffic from its ISP customers;
- adjust the switching rate that applies to local traffic to account for the fact that the average ISP call lasts seven to eight times longer than the average local call;
- allow Focal compensation for no more than a single switching operation, because Focal provides neither a second switching operation nor transport when it delivers ISP traffic; and
- provide for the parties' agreement to be modified promptly in the event that future developments indicate that an adjustment is in order.

(Section VI *infra*).)

7. If the Commission decides to award inter-carrier compensation on ISP traffic, the rate that Focal should be allowed to charge Ameritech Illinois is $0.000946 per minute. That is the best available estimate that balances Focal's cost for the one switching operation it performs when it delivers traffic to its ISP customers (adjusted, as Staff agrees it must be, to account for the long hold times of ISP calls) against the maximum of five cents per call in revenues generated by a residential customer's call to an ISP. (Section VII *infra*.)

ARGUMENT

I. THE COMMISSION SHOULD REQUIRE THE PARTIES TO ABIDE BY THE FCC'S FORTHCOMING DECISION.

If the Commission asserts jurisdiction to decide Issue 2, it should simply require the parties' agreement to provide that the parties will abide by the FCC's forthcoming resolution of the issue in its generic docket on ISP traffic, *No. 99-68* (*In the Matter of Inter-Carrier Compensation for ISP-Bound Traffic*). This Commission took affirmative steps to urge the FCC to decide the ISP issue in that docket. It said:

> Compensation for inter-carrier transport and termination of ISP-bound traffic should be determined by the FCC in a generic proceeding. The ICC is not prepared at this time to recommend any specific billing arrangements. (Reply Comments of the Illinois Commerce Commission in FCC Docket No. 99-68, April 26, 1999, at 2.)

Having successfully advocated the proceeding that the FCC is now conducting, the Commission should not delve into this highly-charged, complex issue only to have its decision rendered obsolete shortly thereafter by the FCC's decision. If it does, it runs the risk not only of having its decision supplanted, but also of producing inconsistent treatments of ISP traffic from one agreement to another in Illinois and (to the extent other commissions do the same) from state to

state.

The Virginia State Corporation Commission reached the conclusion that Ameritech Illinois recommends here in a recent decision where the ISP issue was raised:

> Given the possibility of conflicting results being reached by this Commission and the FCC, we believe the only practical action is for this Commission to decline jurisdiction and allow the parties to present their cases to the FCC. The FCC should be able to give the parties a decision that will be compatible with any future determinations that it might issue. Being unable to determine the FCC's ultimate resolution of these issues, any decision by us would be compatible with such rulings only by coincidence. *(Petition of Starpower Communications, LLC, for Declaratory Judgment Interpreting Interconnection Agreement with GTE South, Inc.,* Case Nos. PUC 990023 *et al.* (Jan. 24, 2000) (Ex. 1 to Ameritech Illinois' Response), at 6.)

As much sense as it made for the Commission to defer Issue 2 to the FCC when Ameritech Illinois first suggested it in its Response, it makes even more sense now. The D.C. Circuit's vacatur of the *ISP Order* has made Issue 2 more complex. As of March 23, Issue 2 was a difficult one, but at least the law was crystal clear that ISP traffic was not local traffic; was interstate, exchange access traffic; was not subject to reciprocal compensation under section 25 l(b)(5) of the 1996 Act; and therefore was not subject to any of the FCC's rules concerning reciprocal compensation, Now, if the Commission undertakes to decide Issue 2 on the merits, it would need at step one to decide from scratch whether ISP traffic is local or not, on a record that was not made for that purpose.

Accordingly, Ameritech Illinois suggests that if the Commission addresses Issue 2, it should require the parties' agreement to provide that

- the parties will compensate each other (or not) for the delivery of Internet traffic to ISP customers in accordance with the FCC's forthcoming decision, subject to the parties' rights to appeal that decision; and

- if the FCC's decision issues after the Effective Date of the agreement, the parties will apply the decision retroactively to the Effective Date of the agreement, with a true-up to be effected within thirty days after the decision issues.

This is an eminently reasonable way for the Commission to ensure an outcome that is fair to the parties and in harmony with controlling federal law.[3]

II. ISP TRAFFIC IS NOT SUBJECT TO RECIPROCAL COMPENSATION UNDER SECTION 251(b)(5) OF THE 1996 ACT, OR TO THE FCC'S RULES IMPLEMENTING SECTION 251(b)(5), BECAUSE IT IS NOT LOCAL TRAFFIC.

Section 251(b)(5) of the 1996 Act imposes on local exchange carriers the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications." In its regulations implementing the Act, the FCC ruled that section 251(b)(5) applies only to local traffic, that is, "traffic that originates and terminates within a local service area." 47 C.F.R. § 51.701. Complementing that ruling, the FCC further determined that "the reciprocal compensation provisions of Section 251(b)(5) for the transport and termination of traffic do not apply to the transport and termination of interstate or intrastate interexchange traffic." First Report and Order, *Implementation of the* Local Competition Provisions *in the Telecommunications Act* of 1996, CC Docket *No.* 96-98, ¶ 1034 (Aug. 8, 1996) *("First Report and Order").* Thus, ISP traffic would be subject to the reciprocal compensation provisions of the 1996 Act, and to the FCC's rules implementing those provisions, if and only if it were local.

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[3] Ameritech Illinois does not believe Focal has taken a position one way or the other on the course recommended above. If Focal does not take issue with Ameritech Illinois' recommendation in its post-hearing brief, it would be all the more clearly appropriate for the Commission to accept that recommendation.

A. An Unbroken Line Of FCC Precedent Holds That ISP Traffic Is Not Local Traffic, but Interstate, Exchange Access Traffic.

The Internet, and thus the ISPs through which end users access the Internet, provides its users the ability to communicate with and receive information from other states and countries. The Supreme Court has characterized the Internet as "a unique and wholly new medium of worldwide human communications." *ACLU v. Reno*, 117 S. Ct. 2329, 2334 (1997). It is the very fact that the Internet allows its users to connect instantaneously to people and sources of information all over the world that makes the Internet what it is, and that has led to the more than 450% increase in Internet traffic that Ameritech Illinois' network has recently experienced (Am. Ex. 2.0 at 8), and to Focal's sale of more than 70% of its lines to ISPs (Am. Ex. 1.0 at 19 n. 27).

It is firmly established that the key to whether a communication is local or interstate is the nature of the communication, rather than the physical location of the facilities that carry it Indeed, "Every court that has considered the matter has emphasized the nature of the communications is determinative, rather than the physical location of the facilities used." *National Association of Regulatory Utility Commissioners v. FCC, 746* F.2d 1492, 1498 (D.C. Cir. 1984). See also, e.g., New *York Tel. Co.* v. FCC, 631 F.2d 1059 (2d Cir.1980).

Consistent with that principle, the FCC has repeatedly ruled, in an unbroken line of decisions over a period of nearly two decades, that Internet calls are interstate, exchange access calls.[4] Most recently, in December of 1999, the FCC, in a decision that is the law unless and

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[4] Because reciprocal compensation applies only to local telecommunications, the dispositive question is whether ISP traffic is local or not local. While we demonstrate in this section that ISP traffic is exchange access, from which it necessarily follows that it is not local, we stress that a determination (if such a determination should someday be made) that ISP traffic is not exchange access does not necessarily imply that it is local. Simply put, reciprocal compensation does not apply to ISP traffic if ISP traffic is not local, whether or not it is exchange

until it is set aside by a federal court of appeals, held:

> [W]e conclude that typically ISP-bound traffic does not originate and terminate within an exchange and, therefore, does not constitute telephone exchange service within the meaning of the [1996] Act. . . . [Rather], such traffic is properly classified as "exchange access."

In the matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket *Nos.* 98-147 *et al.*, ¶ *16* (Dec. *23,* 1999) ("*Advanced Service Remand Order").*

The *Advanced Service Remand Order* is in accord with FCC rulings that date back to 1983, when the FCC, in anticipation of the divestiture of the Bell Operating Companies, created the access charge regime. At that time, the FCC held that "enhanced service providers" — which includes ISPs[5] — "obtain[] local exchange services or facilities which are used, in part or in whole, for the purpose of completing *interstate* calls." *MTS and WATS Market Structure, 97* F.C.C.2d 682, ¶ 78 (1983).[6] See also *id* ¶ 83 (enhanced service providers "employ exchange service for jurisdictionally *interstate* communications"). In this respect, the FCC explained that ISPs were indistinguishable from long-distance telephone companies *(id* ¶ *78):*

> *Among the variety* of users of *access service* are facilities-based carriers, resellers (who use facilities provided by others), sharers, privately owned systems, *enhanced service providers,* and other private line and WATS customers, large and small, who 'leak' traffic into the exchange. *In each case the user obtains local exchange services orfacilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location and, commonly, another*

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access.

[5] *See In re Access Charge Reform Price Cup Performance Review for Local Exchange Carriers,* CC Dockets 96-262 et al., Third Report and Order, 11 F.C.C. Rcd. 21354, ¶ 284 (1996) (the "category of enhanced services . . includes access to the Internet").

[6] All emphases are added unless otherwise noted.

location in the exchange area.

As the FCC recognized in that passage, the "interstate calls" facilitated by enhanced service providers merely "transit" the provider's location. In other words, Internet calls do not terminate at the ISP's location. Driving the point home, the FCC further stated that the overwhelming majority of ISP traffic does not terminate at the ISP's premises, noting that an enhanced service provider *"might terminate few calls at its own location* and thus would make, *relatively heavy interstate use of local exchange services andfacilities." Id.* ¶ 78.[7]

The FCC has repeatedly confirmed this holding over the past 15 years. *See Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers,* Notice of Proposed Rulemaking, 2 F.C.C. Rcd. 4305, ¶ 7 (1987) (ISPs, "like facilities-based interexchange carriers and resellers, use the local network to provide *interstate* services"); *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers,* Order, 3 F.C.C. Rcd. 2631, ¶ 2 (1988) (describing enhanced service providers as "providers of interstate service" and "exchange access users"); *In re Access Charge Reform,* First Report and Order, FCC 97-158, CC Docket Nos. 96-262 et al., ¶ 341 (May 16, 1997) (ISPs "may use incumbent LEC facilities to originate and terminate interstate calls").

The FCC reaffirmed this line of authority in a 1998 Report to Congress:

> When it established the interstate access charge regime in the early 1980s, the Commission determined that enhanced service providers, *even though they used local exchange networks to originate and terminate interstate services,* would not be subject to access charges. Instead, enhanced service providers pay local business rates to LECs for their connections to the LEC network. *(In re Federal-*

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[7] One would expect, as the FCC observed, that a few, non-Internet calls — such as regular telephone calls by subscribers to an ISP's business offices, or personal telephone calls to its employees — would terminate at an ISP's location. Such non-Internet traffic is not at issue here.

State Joint Board on Universal Service, FCC 98-67, Report to Congress, CC Docket No. 96-45, ¶ 146 (April *10,* 1998) *("Universal Service Report").*

Later that year, the FCC once again confirmed that it "traditionally has characterized the link from an end user to an [ISP] as an interstate *access* service." *In re GTE Telephone Operating Cos.; GTOC Tariff No. I; GTOC Transmittal* No. 1148, CC Docket No. 98-79, ¶ 21 (F.C.C. Oct. *30,* 1998) *("GTE Tariff Order").* In that same order, the FCC stressed (at ¶ 19) that ISP calls "do not terminate at the ISP[ ]. but continue to the ultimate destination or destinations, very often at a distant Internet website accessed by the end user." Thus, the Internet call that passes *through* the ISP is "a continuous transmission from the end user to a distant Internet site." *Id.* ¶ 20.

As we have emphasized (see n.4 *supra),* reciprocal compensation does not apply to ISP traffic if ISP traffic is not local, whether or not it is exchange access. But even if one assumes (as some have argued) that every telecommunication is either local or exchange access, the FCC has squarely and recently held that ISP traffic is exchange access. In its December 23, 1999, *Advanced Service Remand Order,* the FCC reiterated (at ¶ 16) that "ISP-bound traffic does not originate within an exchange and, therefore, does not constitute telephone exchange service within the meaning of the Act. *[S]uch traffic isproperly classified as 'exchange access."'* Indeed, the FCC went so far as to overrule a statement it had previously made that suggested that ISPs do not obtain exchange access (and that CLECs had cited for the proposition that ISP traffic is local and therefore subject to reciprocal compensation). Specifically, the FCC, after reaffirming that ISP traffic is exchange access, stated:

> We recognize that we did hold, in the *Non-Accounting Safeguards Order,* that ISPs do not receive "exchange access services because of their status as

non-carriers." However, that Order constitutes a departure from other Commission precedent on this matter. . .

> On a more complete record in this proceeding, we correct the inconsistency in our prior orders and overrule the determination we made in the *Non-Accounting Safeguards Order* that non-carriers may not use exchange access services. We find that this conclusion is consistent with the Commission's longstanding characterization of the service that LECs offer to enhanced services providers (which include ISPs) as exchange access. In MTS *and WATS Markets Structure Order,* the Commission held that "[a]mong the variety of users of access services are enhanced service providers." Similarly, we noted in the *Amendment of Part 69 of the Commission's Rules Relating to Enhanced Service Providers* that enhanced service providers use "exchange access service."

Advanced Services Remand Order, ¶¶ 42, 43 (footnotes omitted). The FCC thus underscored that ISP traffic is exchange access, *i.e.*, non-local, traffic, and that its precedents, with the single exception of the one it overruled, had always so held.[8]

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[8] The exemption of ISP traffic from access charges confirms that the traffic is exchange access traffic. The FCC initially intended to establish uniform access charges "covering those services that make identical or similar use of access facilities," including the information services provided by "enhanced service providers" such as ISPs. *MTS and WATS Market Structure, 93* F.C.C. 2d 241,250 (1983). On reconsideration, however, the FCC exempted ISPs. *MTS and WATS Market Structure,* 97 F.C.C.2d 682, ¶ 83 (1983). The exemption was not based on a determination that such traffic was local. On the contrary, the FCC reaffirmed that "enhanced service providers obtain[] local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls . ." *Id.* ¶ 78. Rather, the access charge exemption was based on policy reasons that expressly recognized that such traffic is exchange access traffic. See *id.* at 715.

The FCC thereafter indicated the ISP exemption would be temporary, and admonished that ISPs "have had ample notice of *our ultimate intent to apply interstate access charges to their operations* and ample opportunity to adjust their planning accordingly." *Amendments to Part 69 of the Commission's Rules Relating to Enhanced Service Providers,* Notice of Proposed Rulemalting, 2 F.C.C. Rcd. 4305, 4306 (1987). The "temporary" exemption has outlived its justification, but the FCC's warning that it would abolish it confirms that it is a true exemption for traffic that would otherwise be subject to access charges.

Finally, the very fact that the FCC asserted jurisdiction over ISP traffic at all, as it did by exempting it from access charges, corroborates that ISP calls are not local. If they were, the FCC would not have had jurisdiction to regulate them in the first place. See 47 U.S.C. §§ 151, 152.

B. The D.C. Circuit's *Bell Atlantic* Decision Suggests An Alternative Reason For Concluding That ISP Traffic Should Not Be Subject To Reciprocal Compensation.

The foregoing demonstrates, without reliance on the FCC's recently vacated *ISP Order*, that ISP traffic is not local, as the FCC most recently held in its December, 1999, *Advanced Service Remand Order, supra*. And from that it follows inescapably that ISP traffic is not subject to section 251(b)(5) reciprocal compensation, because the FCC has ruled that section 251(b)(5) applies only to local traffic. *47* C.F.R. § 51.701, *First Report and Order* ¶ 1034.

In vacating the *ISP Order*, however, the D.C. Circuit posed a question about *why* ISP traffic should not be subject to reciprocal compensation that Ameritech Illinois is eager to answer. The Court put it as follows:

> The issue at the heart of this case is whether a call to an ISP is local or long-distance. Neither category fits clearly. The [FCC] has described local calls, on the one hand, as those in which LECs collaborate to complete a call and are compensated for their respective roles in completing the call, and long-distance calls, on the other, as those in which the LECs collaborate with a long-distance carrier, which itself charges the end-user and pays out compensation to the LECs. [Citation omitted.]
>
> Calls to ISPs are not quite local, because there is some communication taking place between the ISP and out-of-state websites. But they are not quite long-distance, because the subsequent communication is not really a continuation, in the conventional sense, of the initial call to the ISP. The Commission's ruling rests squarely on its decision to employ an end-to-end analysis for purposes of determining whether ISP-traffic is local. . But [the FCC] has yet to provide an explanation why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.

Bell Atlantic (Attachment 1) at p. 6 of 10.

What the Court is saying is this: We understand that there are two models of inter-carrier

compensation. In one, the model that applies to local calls, two LECs collaborate to complete the call, and the originating LEC compensates the terminating LEC. In the other, the model that applies to long-distance calls, two LECs collaborate with a long-distance carrier to complete the call, and the long-distance carrier compensates the two LECs. Tell us why ISP traffic fits into the long-distance model rather than the local model.

The legal answer to that question is that the originating LEC provides local exchange service for the local call, but provides exchange access for the long-distance call and, likewise, for the ISP call. And the reason this matters-for purposes of compensation as opposed to "just" regulatory jurisdiction — is, as the FCC has repeatedly held, that the ISP is subject to the imposition of access charges, just like the long-distance carrier. Putting it in the terms that the *Bell Atlantic Court* used when it posed its question, the call to the ISP fits within the compensation model of a long-distance carrier collaborating with two LECs because the ISP, like the IXC, is subject to the imposition of access charges. The FCC has exempted the ISP from the charges, but it has not changed the model.

Above and beyond the legal answer to the D.C. Circuit's question, however, there is also a deeper, and perhaps more satisfying, answer that lies in a comparison of the economic relationships among the parties to a local call, a long-distance call and an ISP call. We provide that answer in subsection 3 below, but first comment on two other aspects of the passage quoted above from the D.C. Circuit's decision.

1. The Court's discussion shows that the Commission should not mechanistically extend reciprocal compensation to ISP traffic. The D.C. Circuit's statement that "ISP calls are not quite local" leads to the conclusion that section 251(b)(5) does not *require*

reciprocal compensation on ISP calls. To be sure, the remainder of the Court's discussion leaves very much open the possibility that one might decide to impose inter-carrier compensation on ISP calls, and we discuss later in this brief why the Commission should not do so. Ameritech Illinois' point here is a limited one: Given that section 251(b)(5) applies only to local calls, the view that "ISP calls are not quite local," assuming the Commission shares it, would foreclose any argument by Focal that section 251(b)(5) controls the Commission's decision on Issue 2.

2. **An ISP call involves only one telecommunication, not** two. The D.C. Circuit was not satisfied with the FCC's explanation for its long-standing end-to-end treatment of ISP calls.[9] If anything is certain, though — not only under the FCC's precedents but under the 1996 Act itself — it is that a telecommunication with the Internet is a unitary and indivisible transmission that runs from the end user, through the ISP's server, and on to the Internet. To be sure, the ISP does provide an *information service* that rides on the telecommunication, but the question here is who should compensate whom for the telecommunication, and the telecommunication (albeit switched at the ISP's server, just as it is switched at Ameritech's central office and then again at Focal's central office) runs straight through from end to end.

The ISP combines '[computer and information processing functions] with transmission to enable users to access Internet content and services.'" *GTE Tariff Order, supra*, ¶ 6. For the ISP traffic at issue here, in other words, Ameritech Illinois and Focal provide pure transmission service, while the ISP offers something *in addition to* (not instead of) transmission. Specifically, the ISP combines telecommunications with enhancements, such as data processing and other

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[9] The further explanation that the FCC has undertaken (see *supra* n. 1) may well address this point.

functions. As the FCC has explained, ISPs "lease lines, and otherwise acquire telecommunications, from telecommunications providers — interexchange carriers, incumbent local exchange carriers, competitive local exchange carriers, and others. In offering services to end users, they conjoin . . transport with data processing, information provision, and other computer-mediated offerings, thereby creating an information service." *Universal Service Report* ¶ 81. And as Congress put it in the 1996 Act, "The term 'information service' means the offering of a capability for generating, acquiring, [etc.] information *via telecommunications." 47* U.S.C. § 41.

Once one understands that ISPs provide transmission plus enhancements, one also understands that telecommunication with the Internet (i.e., the transmission) runs end to end, from ISP subscriber to the Internet. As the FCC explained in the *GTE Tariff Order* (at ¶ 20), the FCC "has never found that 'telecommunications' ends where 'enhanced' information service begins. . Under the definition of information service [in] the 1996 Act, an information service, while not a telecommunications service itself, is provided *via telecommunications."* Thus, ISP traffic is "a continuous transmission from the end user to a distant Internet site." *Id.*

3. There is an additional reason that the compensation scheme for ISP traffic should be modeled on the compensation scheme for long-distance traffic, rather than local traffic. The core question posed by the D.C. Circuit in its *Bell Atlantic* decision is "whether a call to an ISP [fits] within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs." *(Id.* (Attachment 1, at p. 6 of 10)). When we provided the legal answer to that question earlier in this subsection C, we stated that we would also furnish another answer, based on a comparison of the economic relations

among the parties to the three types of calls. The comparison is straightforward:

- In the case of a local call, the originating end user is making use of his ongoing contractual relationship with his local exchange carrier. The end user pays his LEC to complete local calls that the end user originates. When the LEC requires a contribution from a second LEC (i.e., call termination) in order to render that service, the first LEC compensates the second LEC for its contribution. This is what the D.C. Circuit called the local call model of two collaborating LECs.

- In the case of a long-distance call, the originating end user is making use of his ongoing contractual relationship with his interexchange carrier. The end user pays his IXC to complete long-distance calls that the end user originates. When (as is generally the case for long-distance calls) the IXC requires a contribution from local exchange carriers (*i.e.*, local network access) in order to render that service, the IXC compensates the LECs for their contribution. This is what the D.C. Circuit called the long-distance model of a long-distance carrier collaborating with two LECs.

- In the case of an ISP call, the originating end user is making use of his ongoing contractual relationship with his ISP. The end user pays his ISP to provide him with access to the Internet. When (as is generally the case with dial-up ISP calls) the ISP requires a contribution from local exchange carriers (i.e., local network access) in order to render that service, the ISP *should* compensate the LECs for their contribution. This is the economic answer to the D.C. Citcuit's question. The call to the ISP fits within the long-distance model of a long-distance carrier collaborating with two LECs rather than the local call model of two collaborating LECs because the ISP's role in the transaction is

exactly the same, as far as the participants' economic functions are concerned, as the IXC's.

Dr. Robert Harris explained this more elegantly (though without anticipating the language of "collaboration" that the D.C. Circuit used):

> Economic efficiency indicates that the Focal ISP should be compensating Ameritech Illinois and Focal for the costs they incur when they help provide the communication between the end-user and the ISP, because the contractual relationship between the ISP and the end-user causes those costs. This is because the ISP is the party who is collecting revenue from the cost-causing contractual relationship .
>
> In fact, the end-user's demand for ISP service causes costs in very much the same way that demand for interexchange services supplied by IXCs causes costs. The similarity in the user-carrier contractual relationship between the ISP case and the IXC case is striking. An IXC, by advertising its interexchange service and signing up customers, establishes a contractual relationship with end-users that causes costs. Existing regulatory arrangements recognize this chain of causation, and therefore permit the LEC costs to be recovered through switched access charges, and the IXCs in turn recover these directly from the end-user. Similarly, when a CLEC provides access allowing its user to make a long-distance call, the CLEC charges the IXC an originating access charge.
>
> In the case of *local* voice traffic, the LEC whose customer originates the call compensates the LEC on whose network the call terminates. This is because in this case (i) the "originating" LEC does have a contractual relationship with its customer that assumes a certain level of local usage, as further discussed below; ad (ii) this type of call does indeed terminate on the second LEC's network from an economic and regulatory perspective.

(Am. Ex. 1.0 at 9-10) (emphasis in original).

For all of the reasons set forth in this Section II, ISP traffic is exchange access traffic. More important (because the bottom line question under section 251(b)(5) of the 1996 Act is whether ISP traffic is local), ISP traffic is not local. This brings the analysis back to where it was as of March 23, 2000, the day before the D.C. Circuit vacated the *ISP Order,* with the next

question for the Commission being whether, in the absence of any controlling statute or rule, it should require Ameritech Illinois to compensate Focal for delivering Internet traffic to its ISP customers.

III. AMERITECH ILLINOIS SHOULD NOT BE REQUIRED TO COMPENSATE FOCAL FOR DELIVERING INTERNET TRAFFIC TO ITS ISP CUSTOMERS BECAUSE AMERITECH ILLINOIS DOES NOT CAUSE THE COSTS THAT FOCAL INCURS WHEN IT DELIVERS THAT TRAFFIC.

A firm that incurs costs to supply services should recover those costs from the customer that caused them. This "cost-causer pays" principle is not in dispute. On the contrary, Focal agrees that "[t]he question to be answered is who is responsible for causing the costs associated with ISP bound traffic." (Verified Statement of Michael Starkey (Focal Ex. 2.0) at 16.)

A. The Costs That ISP Traffic Imposes On The Local Network, Are Caused By The ISP's Subscriber Making Use Of The Service For Which He Has Contracted With The ISP.

The cause of the costs associated with ISP traffic lies in a characteristic of ISP traffic that makes it fundamentally different in terms of cost causation from all local traffic. That characteristic is this: Every ISP call occurs *because* the ISP subscriber who originates it has purchased services from the ISP which he can use only by employing the local network. Unlike the local exchange customer who uses the local network to communicate with a pizza parlor, a bank or a lawyer, the customer who dials up the Internet has a pre-existing contract with the party whose number he dials pursuant to which (i) he purchases from the ISP a service that by its very nature can be accessed only via the local network; (ii) in order to avail himself of this service, he dials a number that the ISP has given him so he can connect with the Internet through the ISP; and (iii) he cannot use the service the ISP sells him except by dialing that number (or one like it)

and thereby making use of the local network.

Dr. Harris demonstrates in his Verified Statement (Am. Ex. 1 .O at 6-11) and Supplemental Verified Statement (Am. Ex. 1.5 at l-3) that it is the ISP/subscriber relationship, rather than the Ameritech Illinois/local exchange customer relationship, that causes the costs of ISP traffic, and that an economic analysis of ISP traffic therefore compels the conclusion that there is no sound basis for requiring Ameritech Illinois to defray the costs that Focal incurs when it serves its ISP customers.

As Dr. Harris explains, ISP traffic imposes costs on the local network *because* the end user avails himself of the service he has purchased from his ISP -or, differently stated, *because* he takes action (dialing the prescribed number) in accordance with the contractual arrangement he made with the ISP. (Am. Ex. 1 .0 at 7-S.) And note that this causal relationship between the ISP/subscriber contract and the costs imposed on the network is evident no matter which end of the chain one starts with: Costs get imposed on the network only because the subscriber enters into an arrangement to buy services from the ISP and then uses those services and, looking at it from the other end, the subscriber enters into the arrangement with the ISP only in order to be able to access the Internet by using (*i.e.*, imposing costs on) the local network.

Focal, of course, argues that the cause of the costs is to be found not in the relationship between the ISP and its subscriber, but in the relationship between Ameritech Illinois and that same person, wearing his local exchange customer hat. According to Focal's theory, the cost-causer is the end user acting as a local exchange customer of Ameritech Illinois, and since Ameritech Illinois "is responsible for the outgoing calls of its customers," Ameritech should be "responsible for paying carriers that carry those callers' traffic." (Focal Ex. 2.0 at 17.)

The question, then, boils down to this: When John Q. Subscriber clicks the AOL icon on his PC and his modem dials his ISP's number to establish an Internet connection, does Subscriber perform that cost-causing action because he is a customer of that ISP or because he is a local exchange customer of Ameritech Illinois? And when the carrier that provides the ISP access to the network (Focal) delivers the call to the ISP and incurs costs to do so, does that happen because Focal's ISP customer has sold Internet access services to Subscriber, or because Ameritech Illinois sold local exchange services to Subscriber?

If one addresses the matter head-on, unfettered by preconceptions based on how ISP traffic has been treated under existing interconnection agreements, one cannot avoid the conclusion that the causer of the costs is not Ameritech Illinois and its relationship with its local exchange customer, but is the ISP and its relationship with its subscriber. Moreover, that conclusion is buttressed by Staffs testimony on causation, even though it was not Staffs intention to support Ameritech Illinois on this point.

Staff witness Phipps accurately testified that "both Focal and Ameritech base their position on who should be responsible for compensation of ISP traffic (i.e., who is the cost causer." (Staff Ex. 2 at 13.) The entirety of Mr. Phipps's pre-filed testimony on that question was:

> Ameritech's position is that, "Focal's costs [for routing ISP traffic] are caused by the contractual relationship between the ISP on the Focal network and the ISP's customer who assesses (sic) the Internet by dialing-up the ISP." Ameritech's argument is flawed. If Ameritech's logic is applied to another end-user of Focal that receives calls, but does not necessarily place calls (i.e., a pizza parlor), Ameritech would be stating that the pizza parlor should compensate Focal for those calls, not Ameritech. Obviously, this is an unrealistic outcome. The fact that a great majority of traffic associated with a certain customer is inbound as opposed to outbound does not mean that Ameritech should not provide

> compensation for this traffic. The fact remains that Focal incurs costs for routing traffic that originates on Ameritech's network. (*Id.* at 13-14.)

Although Mr. Phipps meant to support Focal on the causation issue, his pizza parlor example actually supports Ameritech. For contrary to Mr. Phipps's suggestion, Ameritech's logic absolutely does not and would not extend to a pizza parlor, because pizza parlors (unlike ISPs) do not enter into arrangements with their customers pursuant to which the customers must call them in order to make use of the purchases they have made from them. The pizza parlor, in other words (again unlike the ISP), does not sell a product that can be used only via the local telephone network. Indeed, Mr. Phipps acknowledged on cross-examination that whereas part and parcel of the service that a subscriber buys from his ISP is that the subscriber must use the local network to establish an Internet connection through the ISP, there is no such arrangement between a pizza parlor and its customers. (Tr. 572-76.) From the point of view of cost causation, then, calls to local pizza parlors are run of the mill local calls, in which the calling party is simply making use of the local exchange service it buys from Ameritech in the most typical way imaginable."[10] As Dr. Harris succinctly put it, the purpose of the pizza shop is to sell pizza, while the purpose of the ISP is to sell Internet access via the public switched network. (Tr. 253.)

On re-direct examination, Mr. Phipps signed onto Staff counsel's suggestion that calls to

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[10] Based on his Verified Statement, it appears that Mr. Phipps chose pizza parlors because they receive more calls than they make, but that attribute has no bearing on the causation question. To be sure, it is relevant to Issue 2 that all ISP traffic is inbound, because that fact, coupled with the enormous and ever-increasing volumes of ISP traffic that the public switched network is now carrying, means that an incorrect outcome on Issue 2 would generate a huge windfall for Focal, with no offsetting benefit to Ameritech running the other way. But the *causation* question does not turn on the one-way nature of the traffic, as evidenced by the fact that there is no mention of that attribute of ISP traffic in Ameritech Illinois' discussion of causation in the text of this brief.

a psychic service would be an "example of traffic consistent with your pizza analogy" (Tr. at 583), but the psychic example does not support Focal's position any more than the pizza parlor example does. Mr. Phipps did not explain how the relationship between the psychic service and its customers would be structured, but there is certainly no indication in the record that there exist psychic services to which one pays a periodic fee in exchange for the right to access the service at will via the public network, as there would have to be in order for the analogy to be pertinent.

More important, though, one cannot possibly come up with an analogy that undercuts Dr. Harris's analysis. The best one could possibly do, even theoretically, would be to find (or invent) a situation where Ameritech Illinois, by force of section 251(b)(5) of the 1996 Act, must pay reciprocal compensation on a class of traffic that is local but that is caused by a contractual relationship between a local exchange customer of the CLEC and a local exchange customer of Ameritech Illinois. But such a situation would show only that section 251(b)(5) yields an uneconomic result for that class of traffic, so that a correction to the statutory scheme would be called for *if* the volume of affected traffic were great enough to fundamentally distort the economics of the telecommunications industry, as reciprocal compensation on ISP traffic has done.

In sum, the costs Focal incurs when it delivers Internet traffic to its ISP customers are caused by the transaction between those ISP customers and their customers, the users of the Internet. According to the bedrock cost causation principle on which Focal and Ameritech Illinois agree, therefore, Focal should recover from its ISP customers the costs Focal incurs when it delivers their traffic. If that is not happening now (and it is by no means clear from the record

to what extent, if any, Focal is or is not recovering its costs from its ISP customers), it is only because the FCC has exempted ISPs from the access charge regime that applies to all other interstate traffic, and because Focal has had no need to recover any of its costs from its ISP customers due to the subsidy it has been receiving from Ameritech Illinois in the form of grossly excessive payments for delivering the traffic, And even if the FCC, by its exemption, has thwarted a correct application of the cost causation principle, the FCC did not (and could not) repudiate or alter the principle itself."

B. **Focal's Cost Causation Theory Does Not Work.**

Considering the tremendous importance of the cost causation question in this proceeding, Focal's treatment of the matter is amazingly skimpy. We quote it in full, with bold numbers added for reference in the discussion that follows. Mr. Starkey says simply:

> **[1]** The question to be answered is who is responsible for causing the costs associated with ISP bound traffic. **[2]** The answer to that question is the local exchange customer that makes the call to the Internet. **[3]** Hence, it is from these customers that costs associated with carrying ISP bound traffic should be recovered. **[4]** Because of its previous monopoly position, Ameritech continues to serve the majority of the customers that place ISP bound calls within its service territory. **[5]** As such, Ameritech is responsible for the outgoing calls of these customers and should, likewise, be responsible for paying carriers that carry those callers' traffic.

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11 Focal argues that even if the economic analysis says it should recover costs (or more costs) from its ISP customers, it cannot do so because the FCC prohibits Focal both from charging ISPs for access and from charging ISPs different local exchange rates than non-ISP business customers. Given that the bulk of Focal's business is ISP business, however (see Am. Ex. 1.0 at 19 n. 27), there is good reason to believe that Focal could tailor its local exchange rates to its ISP customers. More important, though, if the economic analysis says, as it does, that Ameritech Illinois should not be covering Focal's costs, Focal's ability or inability to recover those costs from the proper source is neither here nor there; the only "explanation" for making Ameritech Illinois pay is that Ameritech is within shooting range and is seen as having deep pockets.

(Focal Ex. 2.0 at 16-17.) And:

> **[6]** [T]he proper economic question to be asked . . is: "Who is the cost causer for whom these investments are being made?' **[7]** End user customers who dial into their ISPs are the cost causers. [S] Hence economic efficiency requires that those customers, not ISP providers, contribute the funds necessary to accommodate the increased growth in dial-up usage. **[9]** The costs associated with carrying calls to the local presence of an ISP are the responsibility of the LEC that serves the customer making the call. **[10]** Not only has the FCC supported this concept; it is the proper economic answer. **[11]** Because end users who dial an ISP are the cost causers, the party that provides those customers access to the network (and hence the ability to generate the costs on the network) must be responsible for the costs those customers generate.

(*Id.* at 29-30.)[12]

If one zeroes in on what Mr. Starkey is actually saying in those eleven sentences, one finds little of substance, and what substance there is does not withstand scrutiny. Specifically:

[1] merely poses the question;

[2] does not advance the discussion; obviously the costs are caused when the end user originates the ISP call; the question remains, though, whether the end user performs that cost-causing action because he is a customer of the ISP or because he is a local exchange customer of Ameritech Illinois;

[3] an *ipse dixit* conclusion following from no analysis and having no explanation, because the fundamental causation question unanswered in sentence **[2]** is still unanswered;

[4] irrelevant to the causation question; causation is what it is regardless whether Ameritech serves few, many or all ISP subscribers;

[5] the first intimation of a cost causation theory by Mr. Starkey; we show below why it does not hold up;

[6] like **[1]**, merely poses the question;

[7] like **[2]**, does not advance the discussion, because does not touch on the question whether

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12 At page 45 of his Verified Statement, lines 11-16, Mr. Starkey again repeats, with minor wording changes, sentences [2] and [11].

end users dial into their ISPs because they are customers of those ISPs or because they are local exchange customers of Ameritech Illinois;

[8] like **[3]**, an *ipse dixit* following from no analysis or reasoning;

[9] another conclusion following from no analysis or reasoning;

[10] rhetorical (and inaccurate in that FCC has not supported Mr. Starkey's causation concept or anything like it);

[11] states Mr. Starkey's theory; we show next why it does not hold up.

Stripped of the packaging, Mr. Starkey's causation theory is articulated in sentences [5] and [11], and it is simply this: When a local exchange customer of Ameritech Illinois imposes costs on the local network, Ameritech Illinois is responsible for those costs because Ameritech Illinois provided the customer access to the network. On its face, that is not much of an analysis. Rather, it is the unreasoned declaration of a rule.[13] Moreover, the rule does not stand up when it is tested in the non-ISP world, as it would have to in order to carry any weight at all.

Consider toll-free long-distance calls, for example. Assume that Ameritech Illinois local exchange customer Jones dials 1-800-CARRENT to arrange to rent a car. Taking Mr. Starkey's rule verbatim from his sentence **[11]**, with just one word change to fit the example, yields the following conclusion: "Because end users who dial an [800 number] are the cost causers, the party that provides those customers access to the network (and hence the ability to generate the costs on the network) must be responsible for the costs those customers generate." That

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[13] Compare Dr. Harris's robust analysis, which builds on the nature of the ISP's business and what the ISP does to promote use of the services it sells (Am. Ex. 1.0 at 7); the economics of the relationship between the ISP and its subscribers *(id.);* the economic literature on cost causation *(id.);* the public policy principles on which the cost causation analysis is based *(id.* at 8-9); and the relationship between the nature of the services demanded by the end user and causation of costs *(id.* at 10).

conclusion, though, is 100% false. When Jones dials 1-800-CARRENT, Am&tech Illinois in actual fact is not responsible for (i.e., is not called upon to pay) the costs that the call imposes on the network. Rather, as Dr. Harris explains (Am. Ex. 1 .0 at 10-l 1): "The access arrangements for toll-free (e.g., l-800 or l-888) service are based on the same logic [as Dr. Harris's causation analysis for ISP traffic]. Many firms [the car rental agency in the example] contract with IXC's so that their customers [Jones] are able to call at no charge to them. In the toll-free case, it is the existence of a contractual relationship between IXC and the called party [the rental agency] that allows costs to be caused. Therefore, the local telephone company that provides service to the calling party is able to recover its costs of originating access, as it is the IXC who has the contractual relationship with the called party." (Am. Ex. 1.0 at 10-1 1.)

Thus, the Commission must choose between a full-blown analysis of cost causation that carefully scrutinizes the economic relationships among all the parties involved in an ISP call, and that works for all forms of traffic against which one tests it (including pizza parlor traffic and l-800 traffic) and, on the other hand, an unsupported rule that does not hold up when it is tested against the real world.

C. In Deciding The Causation Question, The Commission Should Consider The Qualifications Of The Witnesses Who Are Advocating The Two Sides Of The Issue.

Pinpointing the cost causer is a question of economics. It is not about engineering, or network functionality, but solely about the workings of the relationships between sellers and purchasers of services. Focal witness Starkey even characterizes the cost causation question as an "economic question." (Focal Ex. 2.0 at 29, line 17.)

Ameritech Illinois' position on cost causation rests on the analysis of Dr. Harris. Focal's

rests on the rule advocated by Mr. Starkey. We demonstrated above why Dr. Harris's opinion is correct and Mr. Starkey's is not. If that demonstration leaves the Commission at all uncertain, the Commission should take into account the respective qualifications of the two witnesses. After all, the Commission is being asked to decide a question of economics, so if one witness is better qualified than the other to opine on economics, the Commission should — absent some compelling reason to do otherwise — attach greater weight to the opinion of the better qualified witness, Illinois law recognizes this: "The testimony of expert witnesses is to be considered in light of their qualifications, the quality of their testimony, and their credibility." *Hull v. Nat'l Freight* Inc., 264 Ill. App. 3d 412, 422-23, 636 N.E.2d 791,799 (1st Dist. 1994). See also *Wiegman v. Hitch-Inn Post of Libertyville*, 308 Ill. App. 3d 789,721 N.E.2d 614,623 (2d Dist. 1999) ("The weight to be assigned to an expert opinion is [to be determined] in light of the expert's credentials and the factual basis of his opinion").

Robert Harris holds a Ph.D. in Economics and has taught graduate level (including Ph.D.) courses in Economics. (Am. Ex. 1 .0 at 2.) He has published extensively in such areas as regulatory policy, telecommunications policy, the economics of telecommunications and the development of competition and interconnection policies in local access and exchange services. *(Id.;* see also the list of publications in Ex. RGH-1 to Am. Ex. 1.) His imposing resume (Ex. RGH-1) includes service as Deputy Director for Cost, Economic and Financial Analysis at the Interstate Commerce Commission and his present position as Professor Emeritus, Business and Public Policy Group at the Haas School of Business. When Dr. Harris says, for example, that "Focal's witness Starkey is quite wrong when he asserts that 'Ameritech causes Focal to incur costs' for ISP traffic" (Am. Ex. 1 .O at 6) and that his own "analysis is supported by a substantial

body of economic research (id. at 7), his testimony should be given great weight.

Michael Starkey, on the other hand, arguably does not even satisfy the threshold qualifications to render an admissible opinion on the economics of cost causation. Polished as he is on the witness stand, Mr. Starkey has no credentials as an economist: no graduate education, no publication, and precious little experience except as a professional witness. Mr. Starkey has, to be sure, learned a good deal about telecommunications in the nine years since he graduated from college. He is no economist, however, and the Commission would be ill-advised to adopt his untutored view on cost causation in preference to the well-rooted opinion of the man who wrote the proverbial book.

IV. FOCAL SHOULD NOT BE AWARDED COMPENSATION FOR ITS COSTS OF DELIVERING ISP TRAFFIC IN THIS PROCEEDING BECAUSE FOCAL DID NOT CARRY ITS BURDEN TO PROVE ITS COSTS.

There is another, separate, reason that the Commission should rule against Focal on Issue 2. Focal is asking the Commission to allow it to recover from Ameritech Illinois the costs Focal incurs when it deliver ISP traffic to its customers. The law does not entitle Focal to use Ameritech Illinois' costs as a proxy for its own, because the FCC rule that allows Focal to use Ameritech Illinois' costs as a proxy for purposes of reciprocal compensation (FCC 47 C.F.R. § 5 1.711) applies only to local traffic. See *infra* Section VI.B. And the FCC has ruled that when a competing carrier cannot use the incumbent's costs as a proxy for its own — even in a case where the carrier is terminating local traffic-the carrier "must prove to the state commission the costs of terminating local calls." *First Report and Order* ¶ 1093. Focal, though, has not even tried to prove what its costs are. Accordingly, Focal's request would properly be denied even if

the Commission were to conclude that Focal should in principle be permitted to *recover* its costs, or some portion of them, from Ameritech Illinois.

As the Petitioner seeking an order that would require Ameritech Illinois to compensate it for certain costs, Focal bore the burden of proving those costs. Moreover, Focal is not asking the Commission for something to which any existing law entitles it, but instead is asking the Commission to fashion a duty that is not required by current law. For that reason, too, Focal bore the burden of proving its case; it was Focal's job to persuade the Commission of the merits of its proposal, not Ameritech Illinois' job to persuade the Commission of its flaws.

Nonetheless, Focal chose not to present anything remotely resembling a study of the costs for which it seeks recovery. And why not? Because "cost studies of this type are expensive and time consuming." (Focal Ex. 2.0 at 48.) To be sure, Focal also claims that FCC rule 51.711 allows Focal to mirror Ameritech Illinois' transport and termination rates, but that claim fails, because rule 5 1.711 does not apply to ISP traffic. (See *infra* Section VI.B.)

Furthermore, the FCC has specifically ruled that a carrier in Focal's position must affirmatively prove its costs. Having concluded in the *First Report and Order* that ILEC termination costs should generally be used as a proxy for CLEC termination costs for local traffic (*i.e.*, having promulgated rule 51.71 l(a)(l)), the FCC went on to establish an exception for CLECs that are paging providers. As the FCC explained, paging providers, being CLECs, "are entitled to mutual compensation for the transport and termination of local traffic," (First *Report and Order* ¶1092), but there was reason to believe, because of the particular characteristics of paging traffic, "that incumbent LECs' forward-looking costs may not be reasonable proxies for the costs of paging providers." *(Id.)* The FCC therefore established an exception to rule

5 1.711 (a) and decided (id.) that paging providers cannot use the incumbent's costs as proxies for their own costs under that rule. (*See* 47 C.F.R. § 51.71 l(c).) Accordingly, and most important for present purposes, the FCC held:

> we direct states, when arbitrating , to establish rates for the termination of traffic by paging providers based on the forward-looking economic costs of such termination to the paging provider. *The pagingprovider seeking termination fees mustprove to the state commission the costs of terminating local calls. (First Report and Order ¶ 1093.)*

That outcome applies even more forcefully to ISP traffic than it did to paging traffic, The paging traffic that the FCC was addressing was undeniably local traffic, and yet the FCC saw that an exception was required to its symmetricality rule for this distinctive type of local traffic. ISP traffic, on the other hand, is not local traffic, and so is not subject to the symmetricality rule in the first place. Moreover, it is absolutely clear, as we demonstrate below, that ISP traffic, like paging traffic, costs less to deliver than local voice traffic. Thus, the Commission should take the direction that the FCC gave the states in the *First Report and Order* and hold Focal to its task of "proving to the state commission the costs of' delivering ISP calls.

Finally, it makes eminently good sense to hold Focal to its burden. Focal has put the Commission in a pickle. It wants the Commission to order Ameritech Illinois to compensate it for costs, but it fails, with no plausible justification, to show what those costs are. Consequently, as we show below, the only way the Commission could set a compensation rate for Focal would be by doing a ball-park guesstimate, using Ameritech Illinois' costs as a starting point-not because the law allows that, but because they are the only costs in the record-and then making two or three obviously necessary adjustments and leaving the rest to chance. Focal's approach absolutely guarantees that the Commission will not be able to set a rate that does a good job of

accomplishing what the Commission wants it to accomplish, because the information the Commission needs just isn't there.

In short, Focal failed utterly to carry its burden, a burden the FCC has said it had to carry, to prove the costs that it seeks. Accordingly, Focal's request should be denied, without prejudice to Focal's right to ask again when it is ready to prove its case.

V. THE COMMISSION MUST AVOID AN INTER-CARRIER COMPENSATION SCHEME THAT ALLOWS FOCAL TO OVER-RECOVER ITS COSTS.

If the Commission decides, contrary to the foregoing, that Ameritech Illinois should be required to compensate Focal for delivering Internet traffic to its ISP customers, the Commission should take great care to ensure that at least Focal does not over-recover-taking into account the revenues it receives from its ISP customers -the costs it incurs when it delivers that traffic.

The volume of ISP traffic that originates on Ameritech Illinois' network, and the rate at which it is growing, is staggering. In the period from March, 1997, to October, 1999, while non-Internet traffic on the network grew by just 2.3%, Internet access minutes grew by more than 450% (477% for residential subscribers alone, to a total of 1.9 billion minutes per month). (Am. Ex. 2.0 at 8.) With this growth likely to continue *(id.)*, an inter-carrier compensation rate that is even a fraction of a cent higher than it "should" be would yield an enormous windfall for Focal and similarly situated recipients of the payments, and an equal forfeiture for Ameritech Illinois.

Dr. Harris describes in detail the undesirable consequences of such a subsidy. The subsidy would of course benefit Focal and (to the extent Focal's arbitrage profits are passed through) Focal's ISP customers and their subscribers. (Am. Ex. 1 .0 at 23-24.) But those subscribers tend to be affluent, and least in need of such a benefit. *(Id.* at 24.) And looking at the

other side of the coin, the ultimate source of the subsidy would be the most disadvantaged ratepayers — those who are not Internet users. *(Id.)*

In addition, a scheme of inter-carrier compensation that over-compensates Focal would disserve every pertinent goal of the Telecommunications Act of 1996. As the FCC has observed, any scheme of inter-carrier compensation for ISP traffic should aim to produce "efficient outcomes" – *i.e.,* to "ensur[e] the broadest possible entry of efficient new competitors, eliminat[e] incentives for inefficient entry and irrational pricing schemes, and provid[e] to consumers as rapidly as possible the benefits of competition and emerging technologies." (*ISP Order* ¶¶ 29, 33.) A skewed system of inter-carrier compensation for ISP traffic, however, ensures the opposite: It reduces competition among LECs; fosters inefficient entry; institutionalizes irrational pricing of local exchange and Internet services; and denies consumers the benefits of emerging technologies.

A. Skewed Compensation for ISP Traffic Impedes the Development of Local Competition.

Over-compensation for delivering ISP traffic gives CLECs strong incentives to sign up ISPs, and at the same time strips them of any incentive to serve customers who use dial-up Internet access, including — and especially -residential customers. The reason is simple: if a CLEC provides originating facilities-based local service to ordinary consumers, it not only forfeits the subsidy for ISP traffic, but puts itself at risk of having to pay that subsidy. Thus, as Dr. Harris explains **(Am.** Ex. 1.0 at 28-30), Focal's proposal would have the perverse effect of turning customers from assets into liabilities, and discouraging local competition for residential customers.

Staff agrees that over-compensating Focal would stymie competition for residential customers. Staff witness Phipps testifies that "Dr. Harris is correct, in theory," on this point (Staff Ex. 2 at 19), though he then goes on to say that the rate he proposes "mitigates this concern" (id.). Mr. Phipps is right, of course, that competition will not be discouraged if Focal is not over-compensated (though Ameritech Illinois does not subscribe to all aspects of Mr. Phipps's proposal for how to accomplish this) — but the pertinent point here is that there is no disputing the basic principle: If Focal is over-compensated, local competition will pay the price.

B. Skewed Compensation Encourages Inefficient Entry and Discourages Efficient Entry.

Over-compensation for delivering ISP traffic is also inconsistent with the 1996 Act's goals of encouraging efficient entry and reducing incentives for inefficient entry in telecommunications markets. Although ISP-related over-compensation unquestionably draws CLECs to the ISP market, it does so indiscriminately-without regard to whether those CLECs can efficiently serve that market. By enabling CLECs to look to their competitors rather than their customers for full cost recovery (and then some), it obviates the need for CLECs to be efficient. At the same time, it reduces the opportunity for ILECs that could serve a particular ISP more efficiently to do so.

The way to spur efficient entry is to allow the competitive process to dictate winners and losers. Over-compensation for delivering ISP traffic co-opts the competitive process. It delivers the ISP market to one sector of the local exchange industry, not because that sector is more efficient, but because it has unique access to a subsidy that can be used to defray costs and lure ISP customers.

C. Over-Compensation Causes Irrational Pricing.

Over-compensation for delivering ISP traffic leads to irrational pricing on every front. First, it compounds the losses already incurred by LECs that originate ISP traffic. Ameritech Illinois' costs of originating ISP access exceed its revenues. (*See* Verified Statement of Eric Panfil (Am. Ex. 2.0) at 9-10 and Exhibits EP-01, EP-02, and EP-03 thereto; Verified Statement of Dr. Kent Currie (Am. Ex. 4) at 6-S). If Ameritech Illinois is required to compensate Focal for delivering ISP traffic, the gap between costs and revenues will widen commensurately. And as Internet use continues to explode, so, too would the gap between Ameritech Illinois' costs and revenues. Thus, inter-carrier compensation would increase exponentially the losses Ameritech Illinois incurs from the origination of dial-up ISP access. This effect would occur even with compensation at a rate that the Commission believes is not over-compensatory, and the effect would be aggravated to the extent the rate is over-compensatory. By widening the gap between costs and revenues, ISP-related compensation takes an economically irrational scheme (the ISP access charge exemption) and makes it even more irrational. Indeed, the imposition of inter-carrier compensation on ISP traffic, by increasing the loss that Ameritech Illinois incurs for originating such traffic, would constitute a taking without just compensation in violation of the United States Constitution.

Over-compensation for delivering ISP traffic also breeds irrational pricing schemes for ISP services. When CLECs recover their costs plus an exorbitant profit from the originating LEC (as they do under the current regime of reciprocal compensation pursuant to Commission interpretations of existing interconnection agreements), they are in a position to offer uneconomic discounts or even free access to entice ISP business. Whether or not Focal currently

engages in such anti-economic practices, over-compensation indisputably creates **a strong** incentive for CLECs in Focal's position to do so.

D. For The Commission To Over-Compensate Focal For Delivering ISP Traffic Would Violate Section 706 Of The 1996 Act Because it Would Discourage Investment In Advanced Services.

Because ISP-related compensation would apply, if at all, only to dial-up ISP traffic, such compensation would reduce the incentives of CLECs and their ISP customers to deploy advanced network capabilities, such as xDSL services. (See Am. Ex. 1 .0 at 28, 34-36.) With inter-carrier compensation offering ISPs the opportunity to receive subsidized access service from a CLEC, why would an ISP risk forfeiting that subsidy by moving to xDSL or other advanced services to connect to its customers? For this Commission to over-compensate Focal for delivering ISP traffic to its customers would, therefore, violate section 706 of the 1996 Act, which provides in pertinent part

> [E]ach State commission with regulatory jurisdiction over telecommunications services shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . .

Mr. Starkey attempts to deflect this concern by showing recent growth in the advanced services sector. (Focal Ex. 2.0 at 55-57.) The attempt, however, demonstrates only Mr. Starkey's unfamiliarity with basic economic principles (or his willingness to ignore them) Growth in the advanced services sector does not refute the proposition that reciprocal compensation (or over-compensation) on ISP traffic operates to retard such growth, but shows only that there are additional factors at play. (If increased use of seat belts happened to coincide with increased auto fatalities, which could certainly happen, would Mr. Starkey argue that seat

belts do not reduce risk, or would he acknowledge that other factors, perhaps more traffic at higher speeds, were affecting the outcome?) To the extent that the Focals of the world are over-compensated for delivering dial-up ISP traffic, they, and any of their ISP customers with whom they share the subsidy, have an undeniable and socially undesirable incentive to maximize dial-up ISP traffic and, therefore, to minimize the use of advanced alternatives.

VI. PRINCIPLES FOR ESTABLISHING A NON-OVER-COMPENSATORY SCHEME OF INTER-CARRIER COMPENSATION FOR ISP TRAFFIC.

While firmly believing the Commission should award Focal no inter-carrier compensation on ISP traffic for the reasons set forth in Sections II through IV above, Ameritech Illinois identifies in this section specific principles that the Commission should follow in order to try to ensure against over-compensating Focal if the Commission decides to require compensation. Then, in Section VII, we recommend a specific rate.

A. Given The Record In This Proceeding, The Commission Has No Alternative But To Use Ameritech Illinois' Costs As The Starting Point For A Compensation Rate For ISP Traffic.

During the evidentiary hearing, Focal suggested it believes there are flaws in the Ameritech Illinois cost studies that are the foundation on which Ameritech's and Staffs proposed compensation schemes are built. If the Commission is going to set a rate for Focal to charge Ameritech Illinois for delivering ISP traffic, however, Focal has given the Commission no choice but to use those Ameritech Illinois cost studies as its starting point. Focal submitted no cost study of its own, and Ameritech Illinois' studies must be presumed to be valid and accurate *at least as the basis for the rates that Ameritech Illinois charges,* because those rates have been approved by this Commission. This is not to say that Ameritech's cost studies accurately reflect

Focal's costs (they surely do not), or that they do not need to be adjusted to conform to the unique characteristics of ISP traffic and Focal's network (they surely do), but only that the Commission should disregard any suggestion by Focal that the studies are inherently flawed in any way.

B. There Is No Basis In Law, Policy, Or Common Sense For Allowing Focal To Charge Ameritech Illinois' Transport And Termination Rates For Delivering ISP Traffic.

Though Focal has given the Commission no choice but to use Ameritech Illinois' transport and termination costs *as the startingpoint* for arriving at a rate (if any) for Focal to charge for delivering ISP traffic, Focal's going-in position that it should be allowed to charge Ameritech Illinois' full transport and termination rates is outlandish.

Focal has argued that even if ISP traffic is not local, Focal should still be allowed to charge for delivering ISP traffic at Ameritech Illinois' reciprocal compensation rates, on the theory that FCC Rule 5 1.711 permits it to charge "symmetrical" rates, *i.e.*, rates equal to the rates that Ameritech Illinois charges for transporting and terminating local traffic. Focal's position is contrary to law and also makes no sense.

1. Focal's position is contrary to law.

According to section 252(d)(2)(A) of the 1996 Act, the reciprocal compensation rates that Focal charges for terminating *local* traffic are to be based on the "additional costs" that Focal incurs for terminating that traffic. In practice, however, Focal's rates for terminating local traffic are not based on Focal's costs, but on Ameritech Illinois' costs. That arguably stretches the statute out of shape, but it is the law, because the FCC ruled that reciprocal compensation rates for local traffic must be "symmetrical," *i.e.*, the CLEC gets to charge the ILEC's rates. 47 C.F.R.

§ 51.711(a)(l).

Rule 5 1.711 does not apply to ISP traffic, however, because ISP traffic is not local and is therefore not subject to the reciprocal compensation provisions of the Act or the FCC's implementing regulations.[14] Nonetheless, Focal asks that it be allowed to charge Ameritech Illinois reciprocal compensation on *ISP traffic* based on *Ameritech Illinois'* costs for terminating *local traffic*. In other words, Focal is asking the Commission to import the symmetricality rule, a questionable rule even in the realm of local traffic where it does apply, into a realm where it does not apply. Focal's position flies in the face of the FCC's treatment of its own rule. For while Focal seeks to extend the rule beyond its proper boundaries, the FCC has recognized, even *in a situation where the rule would otherwise have applied by its terms,* that where the evidence does not affirmatively show that the cost of delivering traffic to a particular type of customer mirrors the cost of delivering "regular" local traffic, there is a possibility of arbitrage, and the incumbent's transport and termination costs are *not* a suitable proxy for the costs of delivering traffic to that particular type of customer.

Specifically, the FCC, having concluded in the *First Report and Order* that ILEC termination costs for local traffic should *generally* be used as a proxy for CLEC termination costs for local traffic, held that that symmetricality rule did not apply to local traffic terminated by paging providers. The FCC reasoned (¶¶ 1092-93):

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[14] Although the *ISP Order* has been vacated, one piece of logic in the Order is unavoidable: Once it is determined that ISP traffic is not local, it necessarily follows, as the FCC concluded at ¶ 26 n.87 of the *ISP Order,* that "the reciprocal compensation requirements of section 251(b)(5) of the Act *and Section 51, Subpart H. of the Commission's rules* do not govern inter-carrier compensation for this traffic." The symmetricality rule, rule 5 1.711 is in Section 51, Subpart H, of the Commission's rules and, thus, indisputably does not apply to ISP traffic if ISP traffic is non-local, exchange access traffic, as the FCC has elsewhere held it is. *See supra* Section II.

> [W]ith respect to interconnection between LECs and paging providers, there should be an exception to our rule that states must establish presumptive symmetrical rates based on the incumbent LEC's costs for transport and termination of traffic. While paging providers are entitled to mutual compensation for the transport and termination of local traffic . we believe that incumbent LECs' forward-looking costs may not be reasonable proxies for the costs of paging providers. Paging is typically a significantly different service than wireline or wireless voice service and uses different types and amounts of equipment and facilities. . In addition, most calls terminated by paging companies are brief (averaging 15 seconds) in duration and contain no voice message, but only an alpha-numeric message of a few characters. *Using incumbent LEC's costs for termination of traffic as a proxy for paging providers' casts, when the LECs' costs are likely higher than pagingproviders' cost, might create uneconomic incentives for pagingproviders to generate traffic simply in order to receive termination compensation. .*
>
> Given the lack of information in the record concerning paging providers' costs to terminate local traffic, we have decided to initiate a further proceeding to try to determine what an appropriate proxy for paging costs would be and, if necessary, to set a specific paging default proxy. In the interim, however, . . we direct states, when arbitrating disputes under section 252(d)(2), to establish rates for the termination of traffic by paging providers based on the forward-looking economic costs of such termination to the paging provider. The paging provider seeking termination fees must prove to the state commission the costs of terminating local calls.

Thus, the FCC held that Rule 5 1.711 (a) does not apply even to a class of *local* traffic when (i) the characteristics of that traffic call into question the presumption that the ILEC's costs are a good proxy for the CLEC's costs, and (ii) there is a "lack of information in the record concerning [the CLEC's] costs." Applying that holding here, it would be a grievous error to apply the symmetricality rule to ISP traffic. In the first place, ISP traffic, unlike paging traffic, is not local, so the question here is whether to *extend* Rule 51.711 beyond its normal reach in the face of an FCC analysis that says the rule does not apply even within its normal reach when the circumstances indicate it should not. Moreover, as we show below, the characteristics of ISP

traffic do not just call into question the presumption that the ILEC's termination costs are a good proxy for the CLEC's costs of delivering ISP traffic; they positively rebut that presumption. Finally, there is a total "lack of information in the record" concerning Focal's costs for delivering ISP traffic, because Focal submitted no cost study and declined to answer Ameritech Illinois' data requests about its costs. Accordingly, for the Commission to apply Rule 51.711 to require Ameritech Illinois to pay Focal for delivering ISP traffic at rates based on Ameritech Illinois' costs for transporting and terminating local traffic would be unlawful and directly at odds with the very symmetricality rule that such a requirement would purport to implement.

2. Focal's position makes no sense.

Given that Rule 51.711 does not apply, Focal's position might be understood as a contention, separate and apart from any rule, that Ameritech Illinois' costs for transporting and terminating local traffic should be used as a proxy for Focal's costs of delivering Internet traffic because the two are equal, or at least roughly equal. Any such contention would be preposterous, however, because, as Staff wholeheartedly agrees (see Staff Ex. 2 at 10-13; 14-19), the per minute costs that Focal incurs to deliver ISP traffic are nowhere near the per minute costs that Ameritech Illinois incurs to transport and terminate local traffic. We demonstrate below how the differences would properly be taken into account in setting a rate for Focal. For present purposes, we mention only the long hold times of ISP calls, which require a significant adjustment to spread set-up costs incurred in the first minute over the entire duration of the call, and the fact, admitted by Focal, that Focal reduces its costs by delivering ISP traffic to collocated customers.

C. Focal Should Be Required To Recover At Least Some Of Its Cost For Delivering ISP Traffic From Its ISP Customers.

As discussed in Section III, the costs that Focal incurs when it delivers traffic to its ISP customers is caused by the contractual relationship between the ISPs and their subscribers, and Focal should therefore be required to look to its ISP customers (but in any event not to Ameritech Illinois) to cover those costs. If the Commission for some reason does not accept that proposition as a basis for denying inter-carrier compensation on ISP traffic altogether, it should at least require Focal to recover some of its costs of delivering traffic to its ISP customers from those customers.

The FCC has made clear that the business rates that ISPs pay for access to the network *(i.e.,* the rates Focal's ISP customers pay Focal) are supposed to be a substitute for the access charges the ISPs would otherwise be required to pay. (Am. Ex. 2.0 at 6-7.) The last time the FCC addressed the exemption issue, it stated:

> We also are not convinced that the nonassessment of access charges results in ISPs imposing uncompensated costs on incumbent LECs. ISPs do pay for their connections to incumbent LEC networks by purchasing services under state tariffs. Incumbent LECs also receive incremental revenue from Internet usage through higher demand for second lines by consumers, usage of dedicated data lines by ISPs, and subscriptions to incumbent LEC Internet access services. To *the extent that some intrastate rate structuresfail to compensate incumbent LECs adequately for providing service to customers with high volumes of incoming* calls, incumbent LECs may address their concerns to state regulators. (First Report and Order, *In re Access Charge Reform,* 12 F.C.C. Rcd. 15,982, ¶ 346 (May 16, 1997)

That statement reflects (a) the FCC's understanding that the tariffed business rates paid by the "customers with high volumes of incoming calls" (i.e., ISPs) are expected to cover the cost of

such traffic, and (b) a bias that any changes to intrastate rates that might be needed should be targeted to the business line rates paid by ISPs, not the rates paid by end users. (Am. Ex. 2.0 at 7.)

Staff has taken the position that Focal should "have the opportunity to recover" its costs. But if the Commission imposes an inter-carrier compensation scheme designed to cover 100% of Focal's costs for delivering ISP traffic, it would not merely be giving Focal the "opportunity" to recover its costs, but instead would be guaranteeing Focal the recovery of those costs without the need to look to its own customer, the ISP, to provide any portion of the recovery. The basic tariff rates for the types of sophisticated business services (e.g. Primary Rate ISDN services and digital trunking) typically used by ISPs have traditionally been priced well above cost in ILEC tariffs. (Am. Ex. 2.5 at 5.) This is one of the ways that the FCC has always expected the costs of ISP traffic to be recovered under its ESP exemption policy. Given that history, it is reasonable to expect that the rates charged to ISPs by Focal (or any other LEC) should be able to cover at least some of the call delivery costs, while still remaining consistent with the basic principles of the FCC's policy. (*Id.*)

D. An Inter-Carrier Rate For ISP Traffic Must Adjust For The Long Hold Times Of Internet Calls.

The following propositions are uncontested:

- Ameritech Illinois' reciprocal compensation switching rates are per minute rates that assume an average call duration of approximately 3 ½ minutes. (Am. Ex. 2.0 at 14; Am. Ex. 2.5 at 9.)
- Those rates are arrived at by melding two cost streams: (1) set-up costs, which are incurred one time per call and do not vary with the duration of the call; and (2) time-sensitive costs that are incurred over the entire duration of the call. (Am. Ex. 2.0 at 14; Am. Ex. 4 at 4-5).

- Since set-up costs are incurred one time per call, they are melded into Am&tech Illinois' per minute reciprocal compensation switching rates by being spread over the 3 ½ minute assumed duration. (Am. Ex. 2.0 at 14; Am. Ex. 4 at 5.) Thus, for example, if the fixed per call set-up cost were 10¢, then approximately 2.85¢ of that 1 0¢ (i.e., 10¢ ÷ 3.5) would be assigned to each minute, so that, on average, the full 1 0¢ set up cost would be recovered on each call.

- The average ISP call, however, is between seven and eight times as long as the average local call — approximately 26 minutes. (Am. Ex. 2.0 at 14.)

- Consequently, if Ameritech Illinois' reciprocal compensation switching rate were applied to ISP calls, the inter-carrier compensation for the average ISP call would recover between seven and eight times the set-up costs that it should recover. (Using the numbers in the example above, a 26-minute call would recover 26 x 2.85¢ = 74.1¢ in set-up costs, even though the call actually cost only 1 0¢ (like all calls) to set up.) (Am. Ex. 2.0 at 14; Am. Ex. 4 at 5-6.)

- Therefore, if Ameritech Illinois' switching rates are going to be used as a starting point for developing an inter-carrier compensation rate for ISP traffic, one necessary adjustment is to re-allocate the fixed set-up cost over the 26-minute duration of the average ISP call. (Again using the numbers in the example, this would mean spreading the fixed 10¢ set up cost over 26 minutes, so that the set-up cost component of the per minute rate would be approximately .385¢ per minute.)

Staff agrees with the foregoing analysis (see Staff Ex. 2 at 10-l 1, 15-16), and it is hard to see how anyone could disagree. Focal does, however.

Focal witness Starkey does not dispute any of the factual premises of the analysis. He seems to accept, for example, that Ameritech's switching rates are based on an average 3 ½ minute call; that ISP calls average 26 minutes; and that one component of current switching rates are fixed set-up costs that have been spread over the average 3 ½ minute call. Mr. Starkey argues, however, that the 3 ½ minute average call that was used to develop Ameritech's switching rates takes into account the existence of shorter-than-average calls and longer-than-average calls; that ISP calls are not the only longer-than average calls; and that there is therefore

no reason to give ISP calls special treatment. (Focal Ex. 2.1 at 6-9.)

Mr. Starkey's argument is shameful. In the first place, ISP calls get special treatment because they are not local calls. The object of the exercise (if the Commission reaches this point) is to come as close as possible to designing an appropriate (non-over-compensatory) rate for a special class of traffic that by law is not subject to reciprocal compensation or reciprocal compensation rates, not to enrich Focal by trying to shoehorn ISP traffic into a rate structure that was designed for other traffic.

In the second place, Mr. Starkey's underlying premise -that ISP traffic is just one of many categories of traffic that could be culled out and called "longer-than-average," is disingenuous. It is ISP traffic, not some other category of traffic, that has grown by more than 450% in the last three years. (Am. Ex. 2.0 at 8.) It is ISP traffic, not some other category of traffic, that has accounted for 100% of the increase in minutes of traffic originated by Ameritech Illinois' residential customers in that same period. (*Id.*) And it is ISPs, not some other category of customers, that buy 72% of the lines that Focal sells. (Am. Ex. 1.0 at 19 n. 27). *If* some other category of calls should emerge in the future that (i) lasts many time longer than local voice traffic; (ii) grows in volume at a rate that dwarfs anything the network has ever seen before; and (iii) is subject to reciprocal compensation by law, then the economics of the situation would warrant a change in the law of reciprocal compensation --- especially *if* (iv) it is one-way traffic, like ISP traffic. In this proceeding, though, Focal has called upon the Commission to deal with ISP traffic, and it is pure fantasy to pretend, as Focal does, that ISP traffic is just any old longer-

than-average local traffic.[15]

Thus, if a compensation rate for ISP traffic is going to be based on Ameritech Illinois' switching rates, those rates must be adjusted (as Ameritech Illinois witness Panfil and Staff witness Phipps have done) for the hold times of ISP traffic.

E. A Compensation Rate That Attempts To Reflect Focal's Costs For Delivering ISP Traffic Will Include Only One Switching Element And No Transport.

Staff witness Phipps, in his Verified Statement, testified that when Focal delivers traffic to its ISP customers, Focal's network performs one switching operation and no transport, and he explained at length why that is so. (Staff Ex. 2 at 11-15.) Mr. Phipps, an obviously impartial and fair-minded witness, was cross-examined extensively on that testimony, and then reaffirmed it without equivocation:

> Q: (By Examiner Woods) Okay, Mr. Phipps, based on all the cross that you went through we are just kind of unclear right now as to what your final position is. Based upon your review of Mr. Starkey's diagram that you discussed with Ms. Hightman has your position now on the recovery of the tandem switching rate changed at all from the position you took when tiling your testimony?

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[15] The 3 ½ minute average local call on which Ameritech Illinois' switching rates are based increases to about 5.1 minutes if ISP traffic is added in (a statistic that itself demonstrates the immensity of ISP traffic). Mr. Starkey suggests at one point that the Commission deal with the long hold times of ISP calls by aggregating local traffic and ISP traffic, deeming the average call 5.1 minutes and spreading the fixed set-up costs over the 5.1 minutes. That suggestion is nonsensical, for at least three reasons: *First,* 5.1 minutes is the average for all local calls plus ISP calls on Ameritech Illinois' network, not Focal's network. And it is Focal's network that counts, because the issue is Focal's recovery of Focal's alleged costs. Given that ISPs constitute the bulk of Focal's customer base, ISP traffic is surely much more dominant on Focal's network than on Ameritech's and the average call on Focal's network is probably closer to 26 minutes than to 5.1 minutes. *Second,* it makes no sense in any event to lump ISP traffic in with local traffic for purposes of developing a rate for ISP traffic, for the reasons stated in the text above. And, *third,* Mr. Starkey's proposal could work only if rates for non-ISP traffic were changed, and no one (including Focal) is proposing that.

A: What I set forth in my testimony is still my position, yes.

Q: And that is your final answer?

A: Yes. I just wish that was for a million dollars.

(Tr. at 578-79.)

Mr. Phipps's final answer was plainly correct. As Mr. Phipps explained in his pre-filed statement, some of the ISP traffic that Focal delivers goes straight to ISPs that collocate in Focal's switching office. Focal witness Barnicle admitted that "the cost of serving customers is less for collocated than non-collocated customers from Focal's perspective." (Tr.112-113.)[16] That is in part because Focal does not incur any transport mileage for that traffic, as Mr. Starkey admitted when he proposed, in the fall-back proposal in his Supplemental Verified Statement, to exclude transport mileage charges for such traffic. (Focal Ex. 2.1 at 26.) It is also in part because of the obvious efficiency (*i.e.*, relative cheapness) of directing the traffic, once it has been switched the one and only time that it is switched by Focal (at the DMS500 in Focal's office depicted on page 14 of Focal Ex. 2.1) to the collocated ISP equipment in the same building.

When Focal delivers traffic to a collocated customer, Focal merely routes the traffic from its end office switch to an intra-building OC48 transport system, which carries the traffic to the customer's equipment a few floors away. (Tr. 146-47). Focal uses similar high-capacity digital transmission systems to connect customers in "on-net" buildings to Focal's end office switch. (Focal. Ex. 2.1 at 14- 15). While Focal claims it uses "transport" facilities to accomplish this, the facilities (and their costs) are more akin to the local loop. Staff witness Phipps agrees. (Tr. 539-40).

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16 Mr. Barnicle's admission is corroborated by Starkey Cross-Exhibit 1, which shows that Focal charges its collocated ISP customers less than it charges its non-collocated ISP customers.

Mr. Phipps testified that Focal can route the traffic to the collocated ISP equipment by means of a simple cross-connect. (Staff Ex. 2 at 11.) Mr. Starkey disagreed, and claimed that Focal chooses to serve its collocated customers with an OC-48 backbone, which, he said, was "about as far removed from a 'simple cross-connect' as one can imagine" and "is likely to require an investment more akin to hundreds of thousand of dollars." (Focal Ex. 2.1 at 12.) That point gets Focal nowhere, however, because the fact remains that Focal performs only the one switching operation, at the DMS500. Indeed, this is a perfect illustration of the consequences of Focal's failure to offer a cost study: Focal asks to be compensated for two switching operations; the record is clear that it performs only one; Focal says, though, that it is doing something extra with its OC-48; but the closest Focal comes to telling the Commission what that something costs is to say that the OC-48 "is *likely* to require an investment more *akin* to hundreds of thousands of dollars." (*Id.*)[17]

Another illustration of the consequences of Focal's failure to offer a cost study can be found in another "correction" that Mr. Starkey made to Mr. Phipps's testimony about collocated ISPs. Where Mr. Phipps testified that "the majority" of Focal's ISP customers are collocated at Focal's central office (Staff Ex. 2 at 11), Mr. Starkey pointed out that a Focal response to a Staff data request indicated that something less than a majority were collocated (Focal Ex. 2.1 at 11). What, though, is the Commission supposed to do with that information? Focal apparently would have the Commission *assume* that the percentage of Focal's ISP traffic that goes to collocated ISPs equals the

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[17] Mr. Starkey also uses some sleight of hand to make his case. His vague reference to something "akin to hundreds of thousands of dollars" for an OC-48 conveniently ignores the fact that an OC-48 transmission system can provide more than 32,000 individual connections to Focal's collocated customers. Even if one assumes the OC-48 system requires a $300,000 investment, that still amounts to less than $10 per connection, and thus represents a monthly cost that would be only a small fraction of $10 for each local loop equivalent connection.

percentage of ISPs that are collocated. That may be the case, but it also may be that the collocated ISPs receive more traffic on average (or less) than the non-collocated ISPs. A proper cost study would answer that question, and would spare the Commission from having to guess what to do with Focal's admission that it costs less to serve collocated ISPs than non-collocated ISPs.

It is not only to collocated ISPs, but to all ISPs, that Focal routes traffic with only one switching operation. There can be no serious contention that Focal performs two switching operations, for the simple reason that each ISP call that Focal routes passes through only one Focal switch. (*See* Focal Ex. 2.1 at 14.) After the call is switched at Focal's DMS500 switch, is passes through a SONET node (id. at 15-16), but Focal does not contend, and cannot contend, that a SONET node is a switch (or performs an operation that costs what switching costs). Moreover, Focal does not incur, and is not entitled to recover, transport costs because, as Mr. Phipps explains, it carries traffic to its non-collocated ISP customers via "high capacity facilit[ies], with capabilities to handle large volumes of traffic at a relatively low cost" (Staff Ex. 2.0 at 11) *and,* in any event, the facilities on which it carries that traffic are loops, not transport *(id.* at 11-12), and Focal is not entitled to charge Ameritech for its loop costs.

VII. AMERITECH ILLINOIS' PROPOSAL.

Once again, Ameritech Illinois is firm in its conviction that the Commission should award Focal no compensation for delivering ISP traffic. This traffic is not local. Ameritech Illinois does not cause the costs Focal incurs when it delivers the traffic to its ISP customers. Focal had not proven its costs. And any over-compensation of Focal for this traffic will undercut the key policy goals of competitive choice for residential customers and investment in advanced services. In the event the Commission does award compensation, however, Ameritech states the following:

When Ameritech Illinois responded to Focal's petition, it tendered this proposal:

(1) As of the Effective Date of the parties' agreement, and for a period of three months thereafter, the parties would compensate each other at the rate of $0.001333 per minute for the delivery of Internet traffic to each other's ISP customers. That rate, as explained in Am. Ex. 2.0 at 14, gave Focal the benefit of Ameritech Illinois' end office switching rate, with the set-up component of the rate correctly adjusted to account for the long hold times of ISP calls.

(2) That rate would be reduced to zero over a period of one year. After the initial three-month period at $0.0013333 per minute, the rate would be reduced to 75% of that rate for months 4-6; to 50% for months 7-9; to 25% for months 10-12; and to zero thereafter. (Am. Ex. 2.0 at 15-16.)

(3) Because Ameritech Illinois should not be required to pay out all of the revenues it receives for originating Internet access calls while retaining nothing to cover the costs it incurs to deliver the traffic, each party's payment to the other for delivery of ISP traffic originated by a particular end user customer of the paying party would be capped at one-half of the local usage revenues that the paying party derives from that customer. (Id. at 16.)

Staff, agreeing with part but not all of the analysis underlying Ameritech Illinois' proposal, recommended that the Commission set a rate of $0.001333 per minute, but without the phase-out or the cap proposed by Ameritech. While Ameritech Illinois did propose $0.001333 as a starting point for a relatively brief phase-out process, it is less appropriate as a permanent arrangement for the duration of the parties' interconnection agreement. Compensation paid at that rate would amount to a

cost to Ameritech Illinois of almost 3 ½ cents on a 26-minute ISP access call. (Am. Ex. 2.5 at 6.) That would represent more than 80% of the revenue that is typically received for such calls. *(Id.)* In addition, Ameritech Illinois bears the cost not only of providing originating switching for the call, but also of transporting it to Focal's point of interconnection, as well as any billing and administrative costs associated with the call. *(Id.)* Given these facts, it is apparent that payment of compensation to Focal at the rate proposed by Staff would not even come close to allowing Ameritech Illinois to recover its costs of ISP access calls under its current untimed local calling area rates.

On a broader basis, Exhibit EP-03 to Am. Ex. 2.0 demonstrated an overall revenue shortfall of $8.48 per month on a "total service" basis for a residential customer using a second line for ISP access, even assuming no compensation is paid to the LEC serving the ISP. Payment of compensation at the rate proposed by Staff would increase this shortfall to $11.60 per month (an increase of $3.12). (Am. Ex. 2.5 at 6.)

Accordingly, given Staffs apparent misgivings about Ameritech Illinois's initial recommendations, Ameritech Illinois offers one further proposal that should mitigate Staffs concerns, while also making some progress towards eliminating the harms that Ameritech Illinois believes are inherent in any arrangement that includes inter-carrier compensation for ISP traffic. The proposal has two parts. First, the proposal includes a compensation element that would be in place for at least one year following the Effective Date of the new agreement between Focal and Ameritech Illinois. It would then provide for the possibility of a change to the compensation arrangement on a going-forward basis that is under the control of the Commission (presuming, of course, that the FCC has not assumed full jurisdiction over this traffic in the interim, in which case the issue becomes moot in any case). (Am. Ex. 2.5 at 8.)

In recognition of the potential harm to both untimed local calling rates and balanced competitive incentives that would result from a continuing, open-ended obligation to pay inter-carrier-compensation on ISP traffic at a level of $0.001333 per minute, and in recognition also of the ability of any LEC serving an ISP to recover at least some of its costs through charges to its customer (see *supra* Section VI.C), the compensation rate would be set at a level of $0.000946 per minute of use. That rate is equal to the cost of the tandem switching element (only) of reciprocal compensation, adjusted to reflect the impact of a 26-minute average hold time on the allocation of setup and duration costs to a melded per-minute rate. This adjusted tandem switching cost was originally computed by Ameritech Illinois in response to the Focal data request cited by Staff, and it also was shown in Exhibits EP-02 and EP-03 to the original Verified Statement of Eric Panfil (Am. Ex. 2.0).

At the proposed rate, the compensation paid for a 26-minute ISP access call ($0.02496) would be approximately one-half of the basic tariff rate (5 cents) for an untimed local call in the Chicago LATA, though it would represent more than 50% of the actual average per-call revenues received by Ameritech Illinois, due to the application of volume and time-of-day discounts to that basic rate. (Am. Ex. 2.5 at 9.) Thus, it would be consistent with Ameritech Illinois' initial recommendation that any compensation paid during the phase-down period should be capped at one-half of the revenues received for an untimed local call. This rate would be in effect for at least one year following the Effective Date of the agreement.

If the Commission orders inter-carrier compensation for ISP traffic in this proceeding, it should require the parties' agreement to provide for the possibility of a prompt adjustment to meet changed circumstances. The rate of change in the telecommunications industry seems to be accelerating each year. Ameritech Illinois believes that even the $0.000946 rate it now proposes is

likely to adversely impact the potential for balanced competitive entry for all customer segments, the market potential for advanced services, and untimed calling rates. (Am. Ex. 2.5 at 10.) Evidence of adverse impacts in the next year could be greater than expected by Staff and could warrant a mid-course correction. (*Id.*) Another possible catalyst for change would be if the typical switch technology used by LECs to serve ISPs were to change quickly, making cost assumptions used in this proceeding (i.e., ISPs served by same technology as ILEC voice customers) no longer valid. (*Id.*) Another possible cause would be significant growth in the average hold times of ISP calls, which also impact the cost assumptions used here. (*Id.*) Additionally, the Commission may be persuaded at some point that it should investigate this issue on a generic basis with participation from all affected parties, as a number of state commissions are now doing. Finally, the FCC could issue a ruling that continues to give the states the responsibility for regulating these compensation arrangements, but with associated regulations that are inconsistent with the results of this proceeding. For all of these reasons, Ameritech Illinois submits that in the context of its rate proposal, and in the context of the. treatment of this issue in a two-party arbitration, it would be prudent to allow for a change to the compensation arrangements applicable to ISP traffic after a period of one year.

Ameritech Illinois therefore proposes that any inter-carrier compensation provisions for ISP traffic in the parties' agreement be subject to renegotiation on 60 days' notice by either party, but with the effective date of any replacement provisions not to precede one year from the initial Effective Date of the agreement. The parties would then negotiate a replacement compensation arrangement, subject to the dispute resolution process in the agreement with the ultimate possibility of a resolution mediated or arbitrated by the Commission. In order to remove any incentive for either party to slow down the negotiation process for the new arrangement, the agreement should specify that the

replacement compensation arrangement would be applied retroactively (if necessary) to the date of cancellation of the initial arrangement.

CONCLUSION

For the reasons set forth above, and as further elaborated and supported in this proceeding, Ameritech Illinois respectfully urges the Commission to rule on Issue 2 as set forth above.

Dated: March 27, 2000

Respectfully submitted,

AMERITECH ILLINOIS

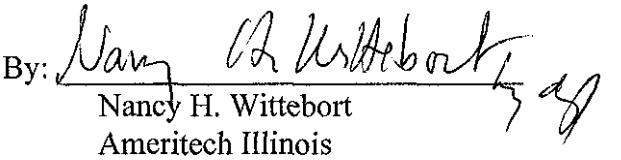
By: 

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EXHIBIT 1

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued November 22, 1999 Decided March 24, 2000

No. 99-1094

Bell Atlantic Telephone Companies,
Petitioner

v.

Federal Communications Commission and
United States of America,
Respondents

Telecommunications Resellers Association, et al.,
Intervenors

Consolidated with
99-1095, 99-1097, 99-1106, 99-1126,
99-1134, 99-1136, 99-1145,

On Petitions for Review of a Declaratory Ruling of the
Federal Communications Commission

Mark L. Evans and Darryl M. Bradford argued the causes for petitioners. With them on the briefs were Thomas F. O'Neil, III, Adam H. Charnes, Mark B. Ehrlich, Donald B. Verrilli, Jr., Jodie L. Kelley, John J. Hamill, Emily M. Williams, Theodore Case Whitehouse, Thomas Jones, Albert H. Kramer, Andrew D. Lipman, Richard M. Rindler, Robert M. McDowell, Robert D. Vandiver, Cynthia Brown Miller, Charles C. Hunter, Catherine M. Hannan, Michael D. Hays, Laura H. Phillips, J. G. Harrington, William P. Barr, M. Edward Whelan, III, Michael K. Kellogg, Michael E. Glover, Robert B. McKenna, William T. Lake, John H. Harwood, II, Jonathan J. Frankel, Robert Sutherland, William B. Barfield, Theodore A. Livingston and John E. Muench. Maureen F. Del Duca, Lynn R. Charytan, Gail L. Polivy, John F. Raposa and Lawrence W. Katz entered appearances.

Christopher J. Wright, General Counsel, Federal Communications Commission, argued the cause for respondents. With him on the brief were Daniel M. Armstrong, Associate General Counsel, and John E. Ingle, Laurence N. Bourne and Lisa S. Gelb, Counsel. Catherine G. O'Sullivan and Nancy C. Garrison, Attorneys, U.S. Department of Justice, entered appearances.

David L. Lawson argued the cause for intervenors in opposition to the LEC petitioners. With him on the brief were Mark C. Rosenblum, David W. Carpenter, James P. Young, Emily M. Wiliams, Andrew D. Lipman, Richard M. Rindler, Robert D. Vandiver, Cynthia Brown Miller, Theodore Case Whitehouse, Thomas Jones, John D. Seiver, Charles C. Hunter, Catherine M. Hannan, Carol Ann Bischoff and Robert M. McDowell.

William P. Barr, M. Edward Whelan, Michael E. Glover, Mark L. Evans, Michael K. Kellogg, Mark D. Roellig, Dan Poole, Robert B. McKenna, William T. Lake, John H. Harwood, II, Jonathan J. Frankel, Robert Sutherland, William B. Barfield, Theodore A. Livingston and John E. Muench were on the brief for the Local Exchange Carrier intervenors.

Robert J. Aamoth, Ellen S. Levine, Charles D. Gray, James B. Ramsay, Jonathan J. Nadler, David A. Gross,

Curtis T. White, Edward Hayes, Jr., and David M. Janas entered appearances for intervenors

Before: Williams, Sentelle and Randolph, Circuit Judges.

Opinion for the Court filed by Circuit Judge Williams.

Williams, Circuit Judge: The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. ss 151-714, requires local exchange carriers ("LECs") to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." Id. s 251(b)(5). When LECs collaborate to complete a call, this provision ensures compensation both for the originating LEC, which receives payment from the end-user, and for the recipient's LEC. By regulation the Commission has limited the scope of the reciprocal compensation requirement to "local telecommunications traffic." 47 CFR s 51.701(a). In the ruling under review, it considered whether calls to internet service providers ("ISPs") within the caller's local calling area are themselves "local." In doing so it applied its so-called "end-to-end" analysis, noting that the communication characteristically will ultimately (if indirectly) extend beyond the ISP to websites out-of-state and around the world. Accordingly it found the calls non-local. See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic, 14 FCC Rcd 3689, 3690 (p 1) (1999) ("FCC Ruling").

Having thus taken the calls to ISPs out of s 251(b)(5)'s provision for "reciprocal compensation" (as it interpreted it), the Commission could nonetheless itself have set rates for such calls, but it elected not to. In a Notice of Proposed Rulemaking, CC Docket 99-68, the Commission tentatively concluded that "a negotiation process, driven by market forces, is more likely to lead to efficient outcomes than are rates set by regulation," FCC Ruling, 14 FCC Rcd at 3707 (p 29), but for the nonce it left open the matter of implementing a system of federal controls. It observed that in the

meantime parties may voluntarily include reciprocal compensation provisions in their interconnection agreements, and that state commissions, which have authority to arbitrate disputes over such agreements, can construe the agreements as requiring such compensation; indeed, even when the agreements of interconnecting LECs include no linguistic hook for such a requirement, the commissions can find that reciprocal compensation is appropriate. FCC Ruling, 14 FCC Rcd at 3703-05 (p p 24-25); see s 251(b)(1) (establishing such authority). "[A]ny such arbitration," it added, "must be consistent with governing federal law." FCC Ruling, 14 FCC Rcd at 3705 (p 25).

This outcome left at least two unhappy groups. One, led by Bell Atlantic, consists of incumbent LECs (the "incumbents"). Quite content with the Commission's finding of s 251(b) (5)'s inapplicability, the incumbents objected to its conclusion that in the absence of federal regulation state commissions have the authority to impose reciprocal compensation. Although the Commission's new rulemaking on the subject may eventuate in a rule that preempts the states' authority, the incumbents object to being left at the mercy of state commissions until that (hypothetical) time, arguing that the commissions have mandated exorbitant compensation. In particular, the incumbents, who are paid a flat monthly fee, have generally been forced to provide compensation for internet calls on a per-minute basis. Given the average length of such calls the cost can be substantial, and since ISPs do not make outgoing calls, this compensation is hardly "reciprocal."

Another group, led by MCI WorldCom, consists of firms that are seeking to compete with the incumbent LECs and which provide local exchange telecommunications services to ISPs (the "competitors"). These firms, which stand to receive, reciprocal compensation on ISP-bound calls, petitioned for review with the complaint that the Commission erred in finding that the calls weren't covered by s 251(b) (5).

The end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate jurisdiction. Here it used the analysis for quite a different purpose, without explaining why such an extension **made sense** in terms of the statute or the Commis-

sion's own regulations. Because of this gap, we vacate the ruling and remand the case for want of reasoned decision-making.

* * *

In February 1996 Congress passed the Telecommunications Act of 1996 (the "1996 Act" or the "Act"), stating an intent to open local telephone **markets** to competition. See H.R. Conf. Rep. No. 104-458, at 113 (1996). Whereas before local exchange carriers generally had state-licensed monopolies in each local service area, the 1996 Act set out to ensure that "[s]tates may no longer enforce laws that impede[ ] competition," and subjected incumbent LECs "to a host of duties intended to facilitate market entry." AT&T Corp. v. Iowa Utils. Bd., 119 S. Ct. 721, 726 (1999).

Among the duties of incumbent LECs is to "provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network . . . for the transmission and routing of telephone exchange service and exchange access." 47 U.S.C. s 251(c) (2). ("Telephone exchange service" and "exchange access" are words of art to which we shall later return.) Competitor LECs have sprung into being as a result, and their customers call, and receive calls from, customers of the incumbents.

We have already noted that s 251(b) (5) of the Act establishes the duty among local exchange carriers "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. s 251(b) (5). Thus, when a customer of LEC A calls a customer of LEC B,

LEC A must pay LEC B for completing the call, a cost usually paid on a per-minute basis. Although s 251(b) (5) purports to extend reciprocal compensation to all "telecommunications," the Commission has construed the reciprocal compensation requirement as limited to local traffic. see 47 CFR s 51.701(a) ("The provisions of this subpart apply to reciprocal compensation for transport and termination of local telecommunications traffic between LECs and other telecommunications carriers."). LECs that originate or terminate long-distance calls continue to be compensated with "access charges, " as they were before the 1996 Act. Unlike reciprocal compensation, these access charges are not paid by the originating LEC. Instead, the long-distance carrier itself pays both the LEC that originates the call and links the caller to the long distance network, and the LEC that terminates the call. See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499, 16013 (p 1034) (1996) ("Local Competition Order").

The present case took the Commission beyond these traditional telephone service boundaries. The internet is "an international network of interconnected computers that enables millions of people to communicate with one another in 'cyberspace' and to access vast amounts of information from around the world." Reno v. ACLU, 521 U.S. 844, 844 (1997). Unlike the conventional "circuit-switched network," which uses a single end-to-end path for each transmission, the internet is a "distributed packet-switched network, which means that information is split up into small chunks or 'packets' that are individually routed through the most efficient path to their destination." In the Matter of Federal-State Joint Board on Universal Service, 13 FCC Rcd 11501, 11532 (p 64) (1998) ("Universal Service Report"). ISPs are entities that allow their customers access to the internet. Such a customer, an "end user" of the telephone system, will use a computer and modem to place a call to the ISP server in his local calling area. He will usually pay a flat monthly fee to the ISP (above the flat fee already paid to his LEC for "se of the local exchange network). The ISP "typically purchases business lines from a LEC, for which it pays a flat monthly fee that allows unlimited incoming calls." FCC Ruling, 14 FCC Rcd at 3691 (p 4).

In the ruling now under review, the Commission concluded that s 251(b)(5) does not impose reciprocal compensation requirements on incumbent LECs for ISP-bound traffic. FCC Ruling, 14 FCC Rcd at 3690 (p 1). Faced with the question whether such traffic is "local" for purposes of its regulation limiting s 251(b) (5) reciprocal compensation to local traffic, the Commission used the "end-to-end" analysis that it has traditionally used for jurisdictional purposes to determine whether particular traffic is interstate. Under this method, it has focused on "the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers." FCC Ruling, 14 FCC Rcd at 3695 (p 10). We save for later an analysis of the various FCC precedents on which the Commission purported to rely in choosing this mode of analysis.

Before actually applying that analysis, the Commission brushed aside a statutory argument of the competitor LECs.

They argued that ISP-bound traffic must be either "telephone exchange service," as defined in 47 U.S.C. s 153(47), or "exchange access," as defined in s 153(16).1 It could not be the latter, they reasoned, because *ISPs* do not assess toll charges for the service (see id., "the offering of access . for the purpose of the origination or termination of telephone toll services"), and therefore it must be the former, for which reciprocal compensation is mandated. Here the Commission's answer was that it has consistently treated ISPs (and *ESPs generally*) as "users of access service," while *treating* them as end u&s merely for access charge purposes. FCC Ruling, **14 FCC** Rcd **at 3701** (p 17).

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1 "Telephone exchange service" is defined as:

> (A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service.

47 U.S.C. s 153(47). "Exchange access" is defined as:

> the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services.

Id. s 153(16).

Having decided to use the "end-to-end" method, the Commission considered whether ISP-bound traffic is, under this method, in fact interstate. In a conventional "circuit-switched network," the jurisdictional analysis is straightforward: a call is intrastate if, and only if, it originates and terminates in the same state. In a "packet-switched network," the analysis is not so simple, as "[a]n Internet communication does not necessarily have a point of 'termination' in the traditional sense." **FCC Ruling, 14 FCC** Rcd at 3701-02 (p 18). In a single session an end user may communicate with multiple destination points, either sequentially or simultaneously. Although these destinations are sometimes intrastate, the Commission concluded that "a substantial portion of Internet traffic involves accessing interstate or foreign websites." Id. Thus reciprocal compensation was not due, and the issue of compensation between the two local LECs was left initially to the LECs involved, subject to state commissions' power to order compensation in the "arbitration" proceedings, and, of course to whatever may follow from the Commission's new. rulemaking on its own possible ratesetting.

* * *

The issue at the heart of this case is whether a call to an ISP is local or long-distance. Neither category fits clearly. The Commission has described local calls, on the one hand, as those in which LECs collaborate to complete a call and are compensated for their respective roles in completing the call, and long-distance calls, on the other, as those in which the LECs collaborate with a long-distance carrier, which itself charges the end-user and pays out compensation to the

LECs. See Local Competition Order, 11 FCC Rcd at 16013 (p 1034) (1996).

Calls to ISPs are not quite local, because there is some communication taking place between the ISP and out-of-state websites. But they are not quite long-distance, because the subsequent communication is not really a continuation, in the conventional sense, of the initial call to the ISP. The Commission's ruling rests squarely on its decision to employ an

❑ end-to-end analysis for purposes of determining whether ISP-traffic is local. There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate. But it has yet to provide an explanation why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.

In fact, the extension of "end-to-end" analysis from jurisdictional purposes to the present context yields intuitively backwards results. Calls that are jurisdictionally intrastate will be subject to the federal reciprocal compensation requirement, while calls that are interstate are not subject to federal regulation but instead are left to potential state regulation. The inconsistency is not necessarily fatal, since under the 1996 Act the Commission has jurisdiction to implement such provisions as s 251, even if they are within the traditional domain of the states. See AT&T Corp., 119 S. ct. at 730. But it reveals that arguments supporting use of the end-to-end analysis in the jurisdictional analysis are not obviously transferable to this context.

In attacking the Commission's classification of ISP-bound calls as non-local for purposes of reciprocal compensation, MCI WorldCom notes that under 47 CFR s 51.701(b)(1) "telecommunications traffic" is local if it "originates and terminates within a local service area." But, observes MCI WorldCom, the Commission failed to apply, or even to mention, its definition of "termination," namely "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." Local Competition Order, 11 FCC Rcd at 16015 (p 1040); 47 CFR s 51.701(d). Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the "called party."

❑ In its ruling the Commission avoided this result by analyzing the communication on an end-to-end basis: "[T]he communications at issue here do not terminate at the ISP's local server . . . . but continue to the ultimate destination or destinations." FCC Ruling, 14 FCC Rcd at 3697 (p 12). But the cases it relied on for using this analysis are not on point. Both involved a single continuous communication, originated by an end-user, switched by a long-distance communications carrier, and eventually delivered to its destination. One, Teleconnect Co. v. Bell Telephone Co., 10 FCC Rcd 1626 (1995), aff'd sub nom. Southwestern Bell Tel. Co. v. FCC, 116 F.3d 593 (D.C. Cir. 1997) ("Teleconnect"), involved an 800 call to a long-distance carrier, which then routed the call to its intended recipient. The other, In the Matter of Petition for

Emergency Relief and Declaratory Ruling Filed by the Bell-South Corporation, 7 FCC Rcd 1619 (1992), considered a voice mail service. Part of the service, the forwarding of the call from the intended recipient's location to the voice mail apparatus and service, occurred entirely within the subscriber's state, and thus looked local. Looking "end-to-end," however, the Commission refused to focus on this portion of the call but rather considered the service in its entirety (i.e., originating with the out-of-state caller leaving a message, or the subscriber calling from out-of-state to retrieve messages). Id. at 1621 (p 12).

ISPs, in contrast, are "information service providers," Universal Service Report, 13 FCC Rcd at 11532-33 (p 66), which upon receiving a call originate further communications to deliver and retrieve information to and from distant websites. The Commission acknowledged in a footnote that the cases it relied upon were distinguishable, but dismissed the problem out-of-hand: "Although the cited cases involve interexchange carriers rather than ISPs, and the Commission has observed that 'it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs,' Access Charge Reform Order, 12 FCC Rcd at 16133, the Commission's observation does not affect the jurisdictional analysis." FCC Ruling, 14 FCC Rcd at 3697 n.36 (p 12). It is not clear how this helps the Commission. Even if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears relevant for purposes of reciprocal compensation. Although ISPs use telecommunications to provide information service, they are not themselves telecommunications providers (as are long-distance carriers).

In this regard an ISP appears, as MCI WorldCom argued, no different from many businesses, such as "pizza delivery firms, travel reservation agencies, credit card verification firms, or taxicab companies," which use a variety of communication services to provide their goods or services to their customers. Comments of WorldCom, Inc. at 7 (July 17, 1997). Of course, the ISP's origination of telecommunications as a result of the user's call is instantaneous (although perhaps no more so than a credit card verification system or a bank account information service). But this does not imply that the original communication does not "terminate" at the ISP. The Commission has not satisfactorily explained why an ISP is not, for purposes of reciprocal compensation, "simply a communications-intensive business end user selling a product to other consumer and business end-users." Id.

The Commission nevertheless argues that although the call from the ISP to an out-of-state website is information service for the end-user, it is telecommunications for the ISP, and thus the telecommunications cannot be said to "terminate" at the ISP. As the Commission states: "Even if, from the perspective of the end user as customer, the telecommunications portion of an Internet call 'terminates' at the ISP's server (and information service begins), the remaining portion of the call would continue to constitute telecommunications from the perspective of the ISP as customer." Commission's Br. at 41. Once again, however, the mere fact that the ISP originates further telecommunications does not imply that the original telecommunication does not "terminate" at the ISP. However sound the end-to-end analysis may be for jurisdic-

tional purposes, the Commission has not explained why viewing these linked telecommunications as continuous works for purposes of reciprocal compensation.

Adding further confusion is a series of Commission rulings dealing with a class, enhanced service providers ("ESPs"), of which ISPs are a subclass. See FCC Ruling, 14 FCC Rcd at 3689 n.1 (p 1). ESPs, the precursors to the 1996 Act's information service providers, offer data processing services, linking customers and computers via the telephone network. See MCI Telecommunications Corp. v. FCC, 57 F.3d 1136, 1138 (D.C. Cir. 1995).2 In its establishment of the access charge system for long-distance calls, the Commission in 1983 exempted ESPs from the access charge system, thus in effect treating them like end users rather than long-distance carriers. See In the Matter of MTS & WATS Market Structure, 97 F.C.C.2d 682, 711-15 (p 77-83) (1983). It reaffirmed this decision in 1991, explaining that it had "refrained from applying full access charges to ESPs out of concern that the industry has continued to be affected by a number of significant, potentially disruptive, and rapidly changing circumstances." In the Matter of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, 6 FCC Rcd 4524, 4534 (p 54) (1991). In 1997 it again preserved the status quo. In the Matter of Access Charge Reform, 12 FCC Rcd 15982 (1997) ("Access Charge Reform Order"). It justified the exemption in terms of the goals of the 1996 Act, saying that its purpose was to "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services." Id. at 16133 (p 344) (quoting 47 U.S.C. s 230(b) (2)).

This classification of ESPs is something of an embarrassment to the Commission's present ruling. As MCI WorldCom notes, the Commission acknowledged in the Access Charge Reform Order that "given the evolution in [information service provider] technologies and markets since we first

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2 The regulatory definition states that ESPs offer "services . . . which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information: provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 CFR s 64.702(a).

established access charges in the early 1980s, it is not clear that (information service providers] use the public switched network in a manner analogous to IXCs [inter-exchange carriers] " 12 FCC Rcd at 16133 (p 345). It also referred to calls to information service providers as "local." Id. at 16132 (p 342 n.502). And when this aspect of the Access Charge Reform Order was challenged in the 8th Circuit, the Commission's briefwriters responded with a sharp differentiation between such calls and ordinary long-distance calls covered by the "end-to-end" analysis, and even used the analogy employed by MCI WorldCom here--that a call to an information service provider is really like a call to a local business that then uses the telephone to order wares to meet the need. Brief of FCC at 76, Southwestern Bell v. FCC, 153 F.3d 523 (8th Cir. 1998) (No. 97-2618). When accused of inconsistency in the present matter, the Commission flipped the argument on its head, arguing that its exemption of ESPs from access

charges actually confirms "its understanding that ESPs in fact use interstate access service; otherwise, the exemption would not be necessary." FCC Ruling, 14 FCC Rcd at 3700 (p 16). This is not very compelling. Although, to be sure, the Commission used policy arguments to justify the "exemption," it also rested it on an acknowledgment of the real differences between long-distance calls and calls to information service providers. It is obscure why those have now dropped out of the picture.

Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling, Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983); 5 U.S.C. s 706(2)(A), we must vacate the ruling and remand the case.

There is an independent ground requiring remand--the fit of the present rule within the governing statute. MCI WorldCom says that ISP-traffic is "telephone exchange service[ ]" as defined in 47 U.S.C. s 153(16), which it claims "is synonymous under the Act with the service used to make local phone calls," and emphatically not "exchange access" as defined in 47 U.S.C. s 153(47). Petitioner MCI WorldCom's Initial Br. at 22. In the only paragraph of the ruling in which the Commission addressed this issue, it merely stated that it

- "consistently has characterized ESPs as 'users of access service' but has treated them as end users for pricing purposes." FCC Ruling, 14 FCC Rcd at 3701 (p 17). In a statutory world of "telephone exchange service" and "exchange access," which the Commission here says constitute the only possibilities, the reference to "access service," combining the different key words from the two terms before us, sheds no light. "Access service" is in fact a pre-Act term, defined as "services and facilities provided for the origination or termination of any interstate or foreign telecommunication." 47 CFR s 69.2(b).

If the Commission meant to place ISP-traffic within a third category, not "telephone exchange service" and not "exchange access," that would conflict with its concession on appeal that "exchange access" and "telephone exchange service" occupy the field. But if it meant that just as ESPs were "users of access service" but treated as end users for pricing purposes, so too ISPs are users of exchange access, the Commission has not provided a satisfactory explanation why this is the case. In fact, in In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, 11 FCC Rcd 21905, 22023 (p 248) (1996), the Commission clearly stated that "ISPs do not use exchange access." After oral argument in this case the Commission overruled this determination, saying that "non-carriers may be purchasers of those services." In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, FCC 99-413, at 21 (p 43) (Dec. 23, 1999). The Commission relied on its pre-Act orders in which it had determined that non-carriers can use "access services," and concluded that there is no evidence that Congress, in codifying "exchange access," intended to depart from this understanding. See id. at 21-22 (p 44). The Commission, however, did not make this argument in the ruling under review.

Nor did the Commission even consider how regarding non-

carriers as purchasers of "exchange access" fits with the statutory definition of that term. A call is "exchange access" if offered "for the purpose of the origination or termination of telephone toll services." 47 U.S.C. s 153(16). As MCI WorldCom argued, ISPs provide information service rather than telecommunications; as such, "ISPs connect to the local network 'for the purpose of' providing information services, not originating or terminating telephone toll services." Petitioner MCI WorldCom's Reply Br. at 6.

The statute appears ambiguous as to whether calls to ISPs fit within "exchange access" or "telephone exchange service," and on that view any agency interpretation would be subject to judicial deference. See Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984). But, even though we review the agency's interpretation only for reasonableness where Congress has not resolved the issue, where a decision "is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service." SEC v. Chenery Corp., 318 U.S. 80, 88 (1943). See also Acme Die Casting v. NLRB, 26 F.3d 162, 166 (D.C. Cir. 1994); Leeco, Inc. v. Hays, 365 F.2d 1081, 1085 (D.C. Cir. 1992); City of Kansas City v. Department of Housing and Urban Development, 923 F.2d 188, 191-92 (D.C. Cir. 1991).

* * *

Because the Commission has not provided a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as "terminat[ing] . . . local telecommunications traffic," and why such traffic is "exchange access" rather than "telephone exchange service," we vacate the ruling and remand the case to the Commission. We do not reach the objections of the incumbent LEC--that s 251(b) (5) preempts state commission authority to compel payments to the competitor LECs; at present we have no adequately explained classification of these communications, and in the interim our vacatur of the Commission's ruling leaves the incumbents free to seek relief from state-authorized compensation that they believe to be wrongfully imposed.

So ordered.

EXHIBIT 2

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Strickling Believes FCC Can Justify Recip Comp Ruling In Face Of Remand

The U.S. Court of Appeals in Washington today vacated and remanded for further consideration the FCC's I999 order regarding intercarrier compensation for traffic bound for Internet service providers (TR, March 1, 1999). Despite some harsh language for the FCC in the court decision, FCC Common Carrier Bureau Chief Lawrence Strickling says he still believes calls to ISPs are interstate in nature and that some fine tuning and further explanation should satisfy the court that the agency's view is correct.

In the 1999 order, the FCC triad to perform a delicate jurisdictional balancing act, finding that calls to ISPs were jurisdictionally interstate but allowing to stand numerous state commission rulings considering such calls to be local. The FCC said it was reasonable for the states to have reached such conclusions because no federal rules on ISP-bound traffic had been in place.

At the same time, however, the FCC launched a proceeding to consider whether to set up a federal compensation regime for ISP- bound traffic. A proposed order has been circulating at the FCC and was expected to go to the Commissioners for consideration within days, sources told TR. Now those plans likely will be put on hold as the agency addresses today's court remand.

In Bell Atlantic Corp., et al v. FCC (consolidated cases beginning at 99-1094), the court remanded the order for "want of reasoned decision-making." The opinion was written by Judge Stephen F. Williams and joined by David B. Sentelle and A. Raymond Randolph.

The court was unhappy with the FCC's application of an "end-to- end" analysis in determining that calls to ISPs are jurisdictionally interstate. Focusing on the end points of the communications,, the FCC had determined that because calls to ISPs could "terminate" at a Web site anywhere, such calls arc jurisdictionally interstate.

Such an "end-to-end" analysis would be straightforward in a circuit-switched world, the court agreed, but it said the FCC's reasons for using such an analysis arc "not obviously transferable in this context." The court pointed to MCI WorldCom, Inc.'s argument that telecommunications traffic is considered local if it "originates and terminates within a local service area."

MCI WorldCom had noted that the FCC failed to apply, or even mention, its definition of "termination"--"the switching of traffic that is subject to section 25 1 (b)(5) [of the Telecommunications Act of 1996] at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises."

The appeals court said, "Calls to ISPs appear to tit this defmi- tion: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the called party." It said the FCC had avoided that result by analyzing the communication on an end-to-end basis, "but the cases it relied on for using this analysis are not on point." The FCC has not explained why an ISP is not, for purposes of reciprocal compensation, "simply a communications-intensive business end user selling a product to other consumer and business end users," the court said.

Mr. Strickling told TR he remains convinced that calls to ISPs should be considered interstate calls. "It seems to me that what the court is really telling us is that we need to better articulate our position," Mr. Strickling said. "I don't read this decision as telling us that we made a mistake" in finding ISP-bound calls to be interstate in nature, he said. "We need to take the confusing precedents and make clear to the court why this is interstate traffic."

Mr. Strickling doesn't expect the decision to have much of an impact on the marketplace. With no federal reciprocal compen-sation regime in place, the states have moved forward to resolve the disputes, and that should continue, he said.

Edward D. Young III, senior vice president-regulatory at Bell Atlantic, agreed with Mr. Strickling's assessment. The court vacated the FCC's order "not because the FCC was wrong, but because, in its view, the FCC did not adequately explain the basis for its conclusion that Internet calls are interstate calls," Mr. Young said.

CLECs disagreed, however. The decision is "very favorable to the CLEC industry," providing more clarity and certainty regarding the compensation CLECs can expect for terminating calls to ISPs, said Jonathan Askin, general counsel at the Association for Local Telecommunications Services.

"This is a very strong ruling," he said. The FCC will be "hard- pressed" to see this as anything other than requiring ISP-bound calls to be local calls, he added. (See Monday's TR for more details.)

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